No. 11556

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

MAGNESIUM PRODUCTS, INC., a corporation,

Appellant,

vs.

NORTH AMERICAN AVIATION, INC., a corporation, and UNITED STATES OF AMERICA,

Appellees.

TRANSCRIPT OF RECORD

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division

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Parker & Company, Law Printers, Los Angeles. Phone TR. 5206.

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italics; and likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible an omission from the text is indicated by printing in italics the two words between which the omission seems to occur.]

Page

NAMES AND ADDRESSES OF ATTORNEYS:

For Appellant:

BAILEY & POE

639 South Spring Street

Los Angeles 14, Calif.

For Appellee North American Aviation, Inc.:

FLINT & MACKAY

Twelfth Floor, Rowan Building

458 South Spring Street

Los Angeles 14, Calif.

For Appellee United States of America:

JOHN F. SONNETT

Assistant Attorney General

JAMES M. CARTER

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RONALD WALKER

ROBERT E. WRIGHT

Assistants U. S. Attorney

600 U. S. Post Office and Court House Building

Los Angeles 12, Calif. [1*]

*Page number appearing at foot of Certified Transcript.

District Court of the United States for the
Southern District of California
Central Division

Civil Action No. 4390-O'C

MAGNESIUM PRODUCTS, INC., a corporation, 1119 Santa Fe Avenue, Los Angeles 21, California,
Plaintiff,

vs.

NORTH AMERICAN AVIATION, INC., a corporation, Inglewood, California,
Defendant.

COMPLAINT FOR MONEY

Plaintiff complains and alleges:

I.

That at all times herein mentioned plaintiff was and now is a corporation organized and existing under and by virtue of the laws of the State of California with its principal place of business located at 1119 Santa Fe Avenue, Los Angeles, California.

That at all times herein mentioned defendant was and now is a corporation organized and existing under and by virtue of the laws of the State of Delaware, and was and now is doing business within the State of California, to-wit, Inglewood, Los Angeles County, California. [2]

II.

That the matter in controversy and the value of the property and property rights involved herein exceeds, ex-

clusive of interest and costs, the sum of Three Thousand Dollars ($3000.00), to-wit, the sum of Twenty Thousand Two Hundred Four and 03/100 Dollars ($20,204.03).

III.

That on or about the 31st day of March, 1945, at the City of Los Angeles, County of Los Angeles, State of California, and within the jurisdiction of the above entitled court, defendant became indebted to plaintiff in the sum of Twenty Thousand Two Hundred Four and 03/100 Dollars ($20,204.03) for goods, wares and merchandise sold and delivered to defendant at its special instance and request; that the agreed price for said goods, wares and merchandise was and is the sum of Twenty Thousand Two Hundred Four and 03/100 Dollars ($20,204.03); that no part of said sum has been paid to plaintiff although demand has been made therefor but to the contrary defendant refuses to pay said sum or any part thereof to plaintiff.

For a Second and Separate Cause of Action Plaintiff Complains and Alleges:

I.

Plaintiff reiterates and repleads all of the allegations contained in paragraphs I and II of its first cause of action as though the same were set forth in full at this portion of its complaint.

II.

Defendant owes plaintiff the sum of Twenty Thousand Two Hundred Four and 03/100 Dollars ($20,204.03) according to the account hereto annexed as Exhibit A together with interest thereon as follows: interest at 7%

per annum on the sum of Sixteen Thousand Eight Hundred Sixty-six and 43/100 Dollars ($16,866.43) from the [3] 6th day of September, 1944; interest at 7% per annum on the sum of One Thousand Three Hundred Ninety-three and 05/100 Dollars ($1,393.05) from the 27th day of February, 1945; and interest at 7% per annum on the sum of One Thousand Nine Hundred Forty-four and 55/100 Dollars ($1,944.55) from the 31st day of March, 1945.

Wherefore, plaintiff prays judgment against the defendant for the sum of Twenty Thousand Two Hundred Four and 03/100 Dollars ($20,204.03) together with interest thereon as follows: interest at 7% per annum on the sum of Sixteen Thousand Eight Hundred Sixty-six and 43/100 Dollars ($16,866.43) from the 6th day of September, 1944; interest at 7% per annum on the sum of One Thousand Three Hundred Ninety-three and 05/100 Dollars ($1,393.05) from the 27th day of February, 1945; and interest at 7% per annum on the sum of One Thousand Nine Hundred Forty-four and 55/100 Dollars ($1,944.55) from the 31st day of March, 1945; for costs of suit herein incurred and for such other and further relief as may be just and equitable.

BAILEY & POE
RUFUS BAILEY
ARLO D. POE

639 South Spring Street
Los Angeles 14, California
Telephone—TRinity 8325 [4]

[EXHIBIT A]

Old Balance	Date	Inv. No.	Charges	Credits	Balance
16,866.43	9-1-44				16,866.43
	1-12-45	72888	5.00		
	1-25-45	73042	45.20		
	1-29-45	73072	117.52		17,034.15
17,034.15	1-30-CM	4032		24.46	17,009.69
17,009.69	2-1-45	73157	73.45		
	2-8-45	73261	197.75		
	2-9-45	73272	1.14		
	2-12-45	73274	50.85		
	2-13-45	73277	85.88		
	2-13-45	73278	56.50		
	2-16-45	73351	291.54		
	2-22-45	73433	148.03		
	2-26-45	73489	196.62		
	2-27-45	73496	148.03		18,259.48
18,259.48	3-6-45	73562	33.90		
	3-17-45	73694	529.97		
	3-22-45	73729	697.21		
	3-31-45	73824	233.91		
	3-31-45	73825	449.56		20,204.03

[Endosed]: Filed Apr. 19, 1945. [5]

[Title of District Court and Cause]

ANSWER

Comes now the defendant, North American Aviation, Inc., a corporation, and for answer to the complaint filed herein, admits, denies and alleges as follows:

I.

Admits the allegations of paragraph I of said complaint.

II.

Admits the allegations of paragraph II of said complaint.

III.

For answer to paragraph III of said complaint, defendant admits that at the City of Los Angeles, County of Los Angeles, State of California, and within the jurisdiction of the above entitled Court, defendant became indebted to plaintiff in the sum of [6] $20,204.03; admits that no part of said sum has been paid to plaintiff, admits that demand has been made therefor; admits that defendant refuses to pay said sum or any part thereof to plaintiff, and in this connection this defendant affirmatively alleges as follows:

(1) That at all times in the complaint herein mentioned there was in force and effect Section 403, incorporated in the Sixth National Defense Appropriation Act, 1942, (Act—April 28, 1942, C. 247—Title IV, Sec. 403,—56 Stat. 245,—50 U. S. C. A., Sec. 1191, as amended) as approved April 28, 1942, as amended by Sec. 801, Title VIII of the Revenue Act of 1942—Laws

of the 77th Congress—2nd Session—Chap. 619—Public Law 753, approved Oct. 21, 1942, and effective as of April 28, 1942, and as further amended by Laws of the 78th Congress—First Session—Chap. 239—Public Law 149, approved July 14, 1943, and effective as of April 28, 1942, which Section 403, as amended, is known as "The Renegotiation Act"; that said Act, as amended as aforesaid, after defining in Subsections (a) (1), (2), (3) and (4), the terms "Department", "Secretary", "renegotiate", "renegotiation" and "excessive profits", provides in Sections (c) (1) and (2) thereof as follows:

> "(c) (1) Whenever, in the opinion of the Secretary of a Department, the profits realized or likely to be realized from any contract with such Department, or from any subcontract thereunder whether or not made by the contractor, may be excessive, the Secretary is authorized and directed to require the contractor or subcontractor to renegotiate the contract price. When the contractor or subcontractor holds two or more contracts or subcontracts the Secretary in his discretion, may renegotiate to eliminate excessive profits on some or all of such contracts and subcontracts as a group without separately renegotiating the contract [7] price of each contract or subcontract.
>
> (2) Upon renegotiation, the Secretary is authorized and directed to eliminate any excessive profits under such contract or subcontract (i) by reductions in the contract price of the contract or subcontract, or by other revision in its terms; or (ii) by withholding, from amounts otherwise due to the contractor or subcontractor, any amount of such exces-

sive profits; or (iii) by directing a contractor to withhold for the account of the United States, from amounts otherwise due to the subcontractor, any amount of such excessive profits under the subcontract; or (iv) by recovery from the contractor or subcontractor, through repayment, credit or suit, of any amount of such excessive profits actually paid to him; or (v) by any combination of these methods, as the Secretary deems desirable. The Secretary may bring actions on behalf of the United States in the appropriate courts of the United States to recover from such contractor or subconstrator, any amount of such excessive profits actually paid to him and not withheld or eliminated by some other method under this subsection. The surety under a contract or subcontract shall not be liable for the repayment of any excessive profits thereon. All money recovered by way of repayment or suit under this subsection shall be covered into the Treasury as miscellaneous receipts."

(2) That this defendant, North American Aviation, Inc., is and was at all of the times in said complaint mentioned a "contractor" within the meaning of that term as used in Sections (c) [8] (1) and (2) above quoted, and is and was at all times in the complaint herein mentioned, engaged in the manufacture and production of airplanes, parts and supplies, under written contracts with the Government of the United States and its "Departments", as that term is defined in said "Renegotiation Act".

(3) That the plaintiff herein, Magnesium Products, Inc., is, and at all of the times in said complaint men-

tioned was, a "subcontractor" within the meaning of that term as used in Sections (c) (1) and (2) above quoted, and was engaged, among other activities, in manufacturing and furnishing to defendant certain magnesium castings and other supplies, used by the defendant in the manufacture and production of airplanes, parts and supplies, under written contracts with the Government of the United States and its Departments, as hereinabove set forth; that the goods, wares and merchandise described in paragraph III of the complaint herein, and all of them, were furnished by plaintiff to defendant for, and were used by defendant in the manufacture and production of airplanes, parts and supplies for the Government of the United States of America, and its "Departments", as aforesaid, and such uses and purposes were at all times known to plaintiff.

(4) Defendant is informed and believes, and upon such information and belief alleges that prior to August 31, 1944, the plaintiff held contracts and subcontracts subject to renegotiation pursuant to the provisions of Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended; that prior to said date renegotiation had taken place between the Under Secretary of War and the said plaintiff, pursuant to the provisions of said Act, for the purpose of eliminating excess profits realized by the plaintiff during its fiscal year ended November 30, 1942, under said contracts and subcontracts; that pursuant thereto and pursuant to the authority and discretion vested in the Secretary of War and others by said Act, duly delegated to the Under Secre- [9] tary of War under Subdivision (f) of said Act, the said Under Secretary of War, on or about June 6, 1944, found and

determined that $250,000.00 of the profits realized by the plaintiff during its fiscal year ended November 30, 1942, under its contracts and subcontracts subject to renegotiation, pursuant to the provisions of said Act, were excessive; that attached hereto, marked Exhibit "A" and by reference in corporated herein and made a part hereof is a true, correct and complete copy of "Determination of Excessive Profits" found and determined by Robert P. Patterson, Under Secretary of War under date of June 6, 1944.

(5) That on or about September 12, 1944, there was served upon this defendant a "Direction to Withhold From Magnesium Products, Inc., of Los Angeles, California, Pursuant to the Renegotiation Act", dated September 6, 1944, signed by Robert P. Patterson, Under Secretary of War, a true, correct and complete copy of which is attached hereto, marked Exhibit "B" and by reference incorporated herein and made a part hereof, which said Direction, issued pursuant to Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, and particularly Subdivision (c) (2) (iii) thereof, directed this defendant to withhold for the account of the United States any and all amounts (not in excess of $40,000.00 in the aggregate) otherwise due or which thereafter should become due from this defendant to said Magnesium Products, Inc., the plaintiff herein.

(6) That thereafter, and on or about September 14, 1944, this defendant advised the said Under Secretary of War, Robert P. Patterson, that it was, pursuant to the direction from the Under Secretary of War, dated September 6, 1944, withholding from monies otherwise due

Magnesium Products, Inc., the plaintiff herein, the sum of $7,820.37.

(7) That thereafter, and on or about October 14, 1944, this defendant received from Robert P. Patterson, Under Secretary [10] of War, a certain telegram amending said letter directive of September 6, 1944, (Exhibit "B" hereto) wherein and whereby this defendant was directed to continue to withhold such amounts as were otherwise due from this defendant to Magnesium Products, Inc., the plaintiff herein, at the close of business on October 14, 1944, and also further directed to withhold no additional amounts until October 30, 1944, on which date this defendant was further directed to resume withholding in accordance with the said letter of September 6, 1944 (Exhibit "B" hereto) until the total of amounts withheld through October 14, 1944 and after October 30, 1944, equalled $33,500.00; that a true, correct and complete copy of said telegram of October 14, 1944, is attached hereto, marked Exhibit "C" and by reference incorporated herein and made a part hereof; that thereafter, and on or about October 17, 1944, this defendant directed a telegram to Robert P. Patterson, Under Secretary of War, in response to said telegram of October 14, 1944 (Exhibit "C" hereto), advising the said Under Secretary of war that the amount withheld from Magnesium Products, Inc., the plaintiff herein, by this defendant was, as of October 10, 1944, $16,866.43; that a true, correct and complete copy of said telegram of October 17, 1944, is attached hereto, marked Exhibit "D", and by reference incorporated herein and made a part hereof; that thereafter, and on or about October 19, 1944, the said Robert P. Patterson, Under Secretary of War, directed a tele-

gram to this defendant, wherein and whereby said telegram of October 14, 1944 (Exhibit "C" hereto) was amended to refer to a total of not less than $16,866.43; that a true, correct and complete copy of said telegram of October 19, 1944, is attached hereto, marked Exhibit "E", and by reference incorporated herein and made a part hereof.

(8) That pursuant to said direction of September 6, 1944, (Exhibit "B" hereto) as amended by said telegram of October 14, 1944, (Exhibit "C" hereto) and said telegram of October 19, 1944, [11] (Exhibit "E" hereto), this defendant has withheld for the account of the United States, from monies otherwise due or which thereafter became due from this defendant to Magnesium Products, Inc., the plaintiff herein, the sum of $20,204.03; that said sum is the aggregate of withholdings made from time to time from August 31, 1944, to and including March 31, 1945, at the times and in the amounts set forth in that certain Statement of Account attached hereto, marked Exhibit "F", and by reference incorporated herein and made a part hereof; that all of said monies, and the total thereof, was withheld solely by reason of said Directive of September 6, 1944 (Exhibit "B" hereto), as amended, and for no other purpose or reason whatsoever, and that but for said Directive said sums and amounts would have been paid by defendant to plaintiff when the same became due respectively; that said Directive of September 6, 1944 (Exhibit "B" hereto), as amended, was, according to its terms, effective immediately, from September 16, 1944, and thereafter until

further notice from said Robert P. Patterson, Under Secretary of War; that no notice revoking, cancelling or terminating said Directive of September 6, 1944, or otherwise modifying this defendant's duty and obligation to withhold, as therein directed, has been received by this defendant from said Robert P. Patterson, Under Secretary of War, or any one else, and the said Directive of September 6, 1944 (as amended) has been at all times, since September 6, 1944, and now is in full force and effect; that by virtue thereof and of said Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, this defendant is required to impound and hold said sum of $20,204.03, and the whole thereof, until such time as this defendant receives further notice from the said Robert P. Patterson, Under Secretary of War; that said sum of $20,204.03 is the amount claimed by said Magnesium Products, Inc., the plaintiff herein, and upon which the [12] complaint in this action is based.

For Answer to the Second and Separate Cause of Action in the Complaint Herein, This Answering Defendant Admits, Denies and Alleges as Follows:

I.

This defendant reiterates and re-pleads all of the allegations contained in paragraphs I and II of its Answer to the first cause of action herein as though the same were set forth in full in this paragraph I of its Answer to plaintiff's second and separate cause of action.

II.

For answer to paragraph II of the second and separate cause of action of said complaint, this defendant admits that it owes plaintiff the sum of $20,204.03; denies that said sum is owed in accordance with the account annexed as Exhibit A to said complaint, but on the contrary alleges that said sum of $20,204.03 is owed from this defendant to plaintiff in accordance with that certain account attached hereto, marked Exhibit "F" and by reference incorporated herein and made a part hereof; denies each and all of the allegations of said paragraph II of the second and separate cause of action of said complaint not herein specifically admitted. For a further, separate and affirmative answer and defense to said second cause of action, this defendant reiterates and re-pleads each and all of the allegations contained in subparagraphs (1), (2), (3), (4), (5), (6), (7) and (8) of paragraph III of its answer to plaintiff's first cause of action as though the same were set forth in full in this paragraph II of defendant's answer to plaintiff's second and separate cause of action.

Wherefore, the defendant prays judgment that the complaint [13] of the plaintiff be dismissed with costs to the defendant.

FLINT & MACKAY

By Edward L. Compton

Attorneys for Defendant North American Aviation, Inc. [14]

[EXHIBIT "A"]

WAR DEPARTMENT
OFFICE OF THE UNDER SECRETARY

Washington

DETERMINATION OF EXCESSIVE PROFITS

Pursuant to Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, which term refers to said Act as last amended 14 July 1943 and as affected by Title VII of the Revenue Act of 1943 so far as applicable.

Whereas, Magnesium Products, Inc. (hereinafter referred to as the Contractor), holds contracts and subcontracts subject to renegotiation pursuant to the provisions of Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended (hereinafter referred to as the Act); and

Whereas, renegotiation has taken place between the Under Secretary of War and the Contractor, pursuant to the provisions of the Act, for the purpose of eliminating excessive profits realized by the Contractor during its final year ended 30 November 1942, under said contracts and subcontracts; and

Whereas, as a basis for said renegotiation the Under Secretary of War considered certain financial, operating and other data, submitted by the Contractor or obtained by the Under Secretary of War from governmental or other reliable sources, relating to the profits realized by the Contractor during said fiscal year under said contracts and subcontracts; and

Whereas, the Contractor has been granted full opportunity to submit such additional information and to present such contentions as the Contractor deemed material in determining the excessiveness of said profits and the renegotiability of such contracts and subcontracts, at hearings of which due notice was given, and due consideration has been given to the financial, operating and other data and information so furnished or obtained and each of the contentions so presented;

Now, Therefore, pursuant to the authority and discretion vested in the Secretary of War, the Secretary of the Navy, the Secretary of the Treasury, the Chairman of the Maritime Commission, the Administrator of the War Shipping Administration, and the respective Boards of Directors of the Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation and Rubber Reserve Company under the provisions of the Act, and duly delegated to the Under Secretary of War under subsection (f) thereof, it is hereby found and determined:

That $250,000 of the profits realized by the Contractor during its fiscal year ended 30 November 1942, under its contracts and subcontracts subject to renegotiation pursuant to the provisions of the Act, are excessive.

That in connection with the payment or discharge by any means of the amount of excessive profits determined hereby to have been realized by the Contractor, the Contractor shall be credited with any amount to which it may be entitled under Section 3806 of the Internal Revenue Code as computed by the Commissioner of Internal Revenue.

That the Contractor is directed to repay such excessive profits less such tax credit, if any, to the Treasurer of the United States.

That the excessive profits so found and determined shall be eliminated by any of the methods provided in the Act or any combination thereof; and the Commanding General, Army Service Forces, and the Commanding General, Army Air Forces, are hereby authorized and directed to take any and all action which may be necessary or desirable to effect such elimination.

6 June 1944.

/s/ Robert P. Patterson
ROBERT P. PATTERSON
Under Secretary of War

A True Copy:
FRANK FOX
Captain, Ordinance Department
War Department Price Adjustment Board

SPRAR-8
5-17-44 [15]

[EXHIBIT "B"]

WAR DEPARTMENT
OFFICE OF THE UNDER SECRETARY
Washington 25, D. C.

6 September 1944.

North American Aviation, Inc.,
Inglewood, California.

Subject: Direction to Withhold from Magnesium Products, Inc., of Los Angeles, California, pursuant to the Renegotiation Act.

Gentlemen:

Pursuant to the authority vested in the Secretary of War under Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, and duly delegated to me, I found and determined on 6 June 1944 that certain of the prices and profits realized by Magnesium Products, Inc., during its fiscal year ended 30 November 1942 under contracts and subcontracts subject to renegotiation were excessive.

In accordance with the authority and duty to eliminate said excessive profits (after allowing to said Magnesium Products, Inc. credit for Federal taxes as provided in Section 3806 of the Internal Revenue Code) I hereby direct you to withhold for the account of the United States any and all amounts (not in excess of $40,000 in the aggregate) otherwise due or which shall become due from you to said Magnesium Products, Inc.

This direction shall be effective immediately and shall continue in effect until further notice from me.

You are also directed to report in writing to the Chairman of the War Department Price Adjustment Board, Room 3D 573, The Pentagon, any amounts which you may from time to time withhold for the account of the United States pursuant hereto.

Very truly yours,

Robert P. Patterson
ROBERT P. PATTERSON
Under Secretary of War

[Stamped]: Received Sep. 12, 1944. Accounting. [16]

[EXHIBIT "C"]

LNA V LA 6
LA 218 V LA 388 NR 1
M
LA22
DA48
FB 18

WA38

LA V WARG NR 166 UD
FROM ROBERT P PATERSON UNDER SECRETARY OF WAR WASHINGTON DC 142209Z

TO NORTH AMERICAN AVIATION INC INGLEWOOD CALIF

GRNC

MY LETTER 6 SEPTEMBER 1944 DIRECTING YOU TO WITHHOLD 40000 FROM MAGNESIUM PRODUCTS INC FOR ACCOUNT THE UNITED STATES IS HEREBY AMENDED AS FOLLOWS YOU ARE TO CONTINUE TO WITHHOLD SUCH AMOUNTS AS WERE OTHERWISE DUE FROM YOU TO MAGNESIUM PRODUCTS INC AT THE CLOSE OF BUSINESS ON 14 OCTOBER 1944 WHICH AMOUNTS I UNDERSTAND TOTAL NOT LESS THAN $24462.24

YOU ARE TO WITHHOLD NO ADDITIONAL AMOUNTS UNTIL 30 OCTOBER 1944 ON WHICH DATE YOU ARE TO RESUME WITHHOLDING IN ACCORDANCE WITH MY LETTER OF 6 SEPTEMBER 1944 UNTIL THE TOTAL OF AMOUNTS

WITHHELD THROUGH 14 OCTOBER 1944 AND AFTER 30 OCTOBER 1944 IS $33500

2301Z

6 1944 $40000 14 1944 $24462.24 30 1944 6 1944 14 1944 30 1944 $33500

RELAY EC 160738PWT

38880C

[Written]: Received 10.10 AM. 10/17/44. P. L. Levengood. [17]

[EXHIBIT "D"]

AAF RESIDENT REPRESENTATIVE
S. G. ANSPACH
TWX TO WASHINGTON, D. C.

OCTOBER 17, 1944

TWX – ROBERT P. PATTERSON
UNDER SECRETARY OF WAR
WASHINGTON, D. C.

TWX-891 RE TWX LA V WARG NR166 WD, OCTOBER 14, 1944, MODIFYING LETTER OF SEPTEMBER 6, 1944 DIRECTING CONTRACTOR TO WITHHOLD FROM MAGNESIUM PRODUCTS, INC. CONTRACTOR REPORTED TO CHAIRMAN WDPAB ON OCTOBER 16, 1944 THAT WITHHOLDING AS OF OCTOBER 10, 1944 WAS $16,866.43. IT IS ESTIMATED THAT THIS FIGURE DID NOT MATERIALLY INCREASE BE-

TWEEN OCTOBER 10 AND OCTOBER 14. THIS IS AT VARIANCE WITH YOUR UNDERSTANDING THAT CONTRACTOR WITHHELD NOT LESS THAN $24,462.24, AND IT IS BELIEVED THAT LARGER FIGURE MAY INCLUDE AMOUNTS BEING HELD BY OTHER CONTRACTORS. MAGNESIUM PRODUCTS, INC. ADVISES TODAY THAT IT WILL NOT DELIVER CASTINGS HENCEFORWARD UNLESS PAYMENT IS MADE ON DELIVERY AND THAT IT WILL NO LONGER WAIVE THIS REQUIREMENT AS IT PREVIOUSLY DID. CONSEQUENTLY, YOUR IMMEDIATE ANSWER IS REQUESTED SO THAT THE CONTRACTOR CAN BUY ON COD BASIS UNTIL OCTOBER 30, 1944,

NORTH AMERICAN AVIATION, INC.
S. G. ANSPACH
SECRETARY – ASST. TREASURER

FBS:vs

cc: Mr. Paul Levengood
Mr. R. Nagely – 2
Mr. F. B. Stone – 3 [18]

[EXHIBIT "E"]

TXXXINGLE 7082 GA PLS
INGLE 7082 V LA 388 NR 1
LA284
WA307
LA V WARA NR59 WD
FROM ROBERT P PATTERSON UNDER SW WASHINGTON DC 918125Z
TO NORTH AMERICAN AVIATION INC INGLEWOOD CALIF

GRNC

REFERENCE YOUR TELEGRAM 17 OCTOBER FROM JOHNSON STOP MY TELEGRAM 14 OCTOBER RESPECT TO MAGNESIUM PRODUCTS INC WITHHOLDING IS HEREBY AMENDED TO REFER TO TOTAL OF NOT LESS THAN $16 866.43 IN LIEU OF $24 462.24 STOP RESPECT COD DELIVERY REFERENCE IS MADE TO LETTER DATED 13 OCTOBER FROM MAGNESIUM PRODUCTS INC RUFUS BAILEY SECRETARY TO DEPARTMENT OF JUSTICE WHICH AGREES THAT DURING PERIOD BETWEEN 13 OCTOBER AND 30 OCTOBER SALES TO YOU WILL BE ON QUOTE CUSTOMARY CREDIT TERMS UNQUOTE END

1840Z

17 14 $16 866.43 $24 462.24 13 13
:: INGLE 7082 R 1 BW TNX
T
39043C

[Written]: Rec'd at 12; B.P. Rec. 10/20/44, 8:15 A. M. PBL [19]

[EXHIBIT "F"]

ACCOUNT

BETWEEN MAGNESIUM PRODUCTS, INC. – CR.
AND NORTH AMERICAN AVIATION INC. – DR.

Invoice Date	Invoice No.	Amount	Date Due	
8/31/44	71185	$ 22.55	9/10/44	Net
"	71186	32.78	"	"
"	71187	487.52	"	"
"	71188	95.92	"	"
"	71189	29.48	"	"
"	71190	1,283.70	"	"
9/ 1/44	71213	6.05	10/10/44	"
"	71214	113.08	"	"
8/22/44	70947	63.80	9/10/44	"
"	70949	118.80	"	"
8/28/44	71077	850.60	"	"
9/ 6/44	71261	9.30	10/10/44	"
"	71262	134.64	"	"
"	71263	5.61	"	"
"	71264	289.30	"	"
"	71265	96.00	"	"
"	71266	1,536.00	"	"
"	71267	239.58	"	"
"	71268	63.36	"	"
"	71269	17.60	"	"
"	71270	1,266.54	"	"
"	71278	576.00	"	"
9/ 7/44	71279	540.32	10/10/44	"
"	71280	583.66	"	"
"	71281	11.88	"	"
"	71282	82.28	"	"

Invoice Date	Invoice No.	Amount	Date Due	
"	71283	7.70	"	"
"	71285	424.16	"	"
9/ 8/44	71296	65.12	"	"
"	71297	19.36	"	"
"	71298	19.36	"	"
"	71299	208.12	"	"
"	71300	1,240.58	"	"
"	71301	438.02	"	"
"	71302	408.00	"	"
"	71303	1,032.00	"	"
9/11/44	71320	843.48	"	"
"	71321	11.12	"	"
"	71322	143.00	"	"
"	71323	2,592.00	"	"
9/12/44	71324	148.06	"	"
"	71325	518.10	"	"
9/13/44	71343	268.62	"	"
"	71344	1,230.24	"	"
9/14/44	71349	9.90	"	"
"	71350	9.68	"	"
"	71351	8.58	"	"
"	71352	64.02	"	"
"	71353	395.34	10/10/44	"
"	71354	143.88	"	"
9/15/44	71389	118.80	"	"
				[20]
9/19/44	71427	$ 11.88	10/10/44	Net
"	71428	85.06	"	"
"	71429	41.14	"	"
9/28/44	71513	12.76	"	"
1/25/45	73402	45.20	2/10/45	"

Invoice Date	Invoice No.	Amount	Date Due	
1/29/45	73072	117.52	"	"
1/23/45	72888	5.00	"	"
2/ 2/45	73157	73.45	3/10/45	"
2/ 8/45	73261	197.75	"	"
2/ 9/45	73272	1.14	"	"
2/12/45	73274	50.85	"	"
2/13/45	73277	85.88	"	"
"	73278	56.50	"	"
2/16/45	73351	291.54	"	"
2/22/45	73433	148.03	"	"
2/26/45	73489	196.62	"	"
2/27/45	73496	148.03	"	"
3/ 6/45	73562	33.90	4/10/45	"
3/19/45	73694	529.97	"	"
3/22/45	73729	697.21	"	"
3/31/45	73824	233.91	"	"
3/31/45	73825	449.56	4/10/45	"

Less our Returned Material Debit:

9/ 9/44	441 CR 107240	–240.00
8/28/44	441 CR 116165	–1,968.00
1/23/45	Our D/M 451 CR 90110	–24.46
		$20,204.03

[21]

Received copy of the within Answer this July 31, 1945. Rufus Bailey, Attorney for Plaintiff.

[Endorsed]: Filed Jul. 31, 1945. [22]

[Title of District Court and Cause]

MOTION FOR SUMMARY JUDGMENT

The pleadings herein having been closed, plaintiff moves the Court for a summary judgment in favor of plaintiff herein upon the grounds and for the reasons that: (a) the answer leaves undenied all of the material allegations of plaintiff's complaint in that defendant's sole defense is based upon acts done and threatened to be done under color of the provisions of the Renegotiation Act which said Act is void and unconstitutional as being unauthorized and violative of the constitution of the United States of America as more fully set forth in plaintiff's memorandum of points and authorities in support of this motion, served and filed concurrently herewith, and (b) upon the further ground that the affirmative defenses of the defendant herein are barred by the [23] statute of limitations set forth in said Renegotiation Act.

Plaintiff further moves that this motion be heard and determined before trial.

BAILEY & POE
By Rufus Bailey
By Arlo D. Poe [24]

Received copy of the within. Flint & Mackay, Nov. 17, 1945. By LK.

[Endorsed]: Filed Nov. 19, 1945. [25]

[Title of District Court and Cause]

NOTICE OF MOTION FOR SUMMARY JUDGMENT

To the Defendant above named and to Flint & Mackay and Edward L. Compton, its attorneys of record:

You are hereby notified that on the 10th day of December, 1945, the plaintiff will bring a motion for summary judgment on for hearing before the Honorable J. F. T. O'Connor, Judge of the above entitled court at his court room at United States Courts and Post Office Building, Los Angeles, California, at 10:00 o'clock A. M. of that day, or as soon thereafter as counsel can be heard.

Said motion will be made upon the motion for summary judgment, the affidavit of E. R. Clayton, and plaintiff's memorandum of points and authorities in support of motion for summary judgment, copies of which are served concurrently herewith and [26] upon all of the pleadings and files herein.

Dated: November 8, 1945.

BAILEY & POE
By Rufus Bailey
By Arlo D. Poe [27]

Received copy of the within. Flint & Mackay, Nov. 17, 1945. By LK.

[Endorsed]: Filed Nov. 19, 1945. [28]

[Title of District Court and Cause]

AFFIDAVIT OF E. R. CLAYTON IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT

State of California, County of Los Angeles—ss:

E. R. Clayton being first duly sworn deposes and says:

That he is now and continuously ever since the 6th day of December, 1938, has been the president of Magnesium Products, Inc., the plaintiff herein; that the plaintiff is a corporation organized and existing under and by virtue of the laws of the State of California, with its principal place of business located at 1119 Santa Fe Avenue, Los Angeles, California.

That at all of the times herein mentioned Henry L. Stimson was the duly appointed, qualified and acting Secretary of War of the United States of America and as such was charged with the duty of administering the Renegotiation Act. [29]

That at all of the times herein mentioned Robert P. Patterson was the duly appointed, qualified and acting Under Secretary of War of the United States of America and as such was also charged with the duty of administering said Renegotiation Act, by direction of and delegation by said Henry L. Stimson as the Secretary of War; that with respect to the matters involved in this action said Robert P. Patterson, as Under Secretary of War, did at all times purport to act by virtue of authority delegated to him by said Henry L. Stimson as the Secretary of War.

That plaintiff is engaged in the business of operating a jobbing foundry wherein it fabricates and sells magnesium alloy sand castings; that all of the business done by plaintiff during the times herein mentioned, ending November 30, 1942, was with private individuals, firms and corporations and not with the United States of America; that plaintiff had no contracts, as such, with any person, firm or corporation or with the United States of America; that all of its said business is and was done upon purchase orders, forwarded to plaintiff by its customers; that all of the magnesium alloy sand castings fabricated and sold by plaintiff, during the times herein mentioned, were sold below the maximum price which had been established and was in effect under the Emergency Price Control Act of 1942, as amended, and were sold at a price below the January 1, 1941, selling price.

Affiant is informed and believes and therefore alleges the fact to be that said Unilateral Determination (Exhibit A to Defendant's Answer), included the total of plaintiff's business done for its fiscal year ending November 30, 1942, without regard to whether each purchase order involved $100,000.00 as required by said Renegotiation Act; that plaintiff at no time had a single purchase order or contract with defendant for $100,000.00 or more;

That the products produced by plaintiff are standard commercial products which are identical in every material respect with [30] the products which are manufactured and sold, as a competitive product by hundreds of other manufacturers throughout the United States and which were in general civilian, industrial and commercial use prior to January 1, 1940; that the products produced by plaintiff were unchanged in any material respect by the

war and were consistently sold at a price not in excess of the January 1, 1941, selling price; affiant is informed and believes and therefore alleges that its selling prices were, during all of the times herein mentioned, well below said ceiling price and far below the prices charged by any other magnesium sand casting foundry in this or any other market area; in this regard affiant is informed and believes and therefore alleges the fact to be that its prices are the lowest in the entire United States; plaintiff's costs have been reduced over a long period of years and as these reductions have occurred its selling prices have been correspondingly reduced.

Plaintiff's operations at all times herein mentioned have been conducted with its own funds and personnel and without any direct or indirect financial assistance from the government and plaintiff has at all times promptly and fully met its obligations to the government of the United States of America, including the full payment of all taxes which plaintiff believes it owed to the government, which, for 1942, were paid in the amount of $381,592.38.

Plaintiff has, in conducting its operations in the war effort, expended considerable effort and expense in assisting smaller concerns and has made available to them plaintiff's engineering and technical staffs, supplies and equipment; that plaintiff has not materially increased its total compensation for its officers and executive employees since 1941 even though the operations of plaintiff have greatly increased and the resulting responsibility and burden on those officers and employees has been correspondingly increased.

Plaintiff has supplied castings in an open competitive market and has, since October 1941, consistently sold at

a price [31] below the O.P.A. ceiling as set by Maximum Price Regulation No. 125. In 1940 plaintiff voluntarily established a blanket price for all magnesium castings of $2.35 per pound; this price was made without regard to the difficulty of castings or intracacy of design; in 1941 plaintiff voluntarily reduced the blanket price to $2.30 per pound; in January of 1942 plaintiff voluntarily reduced its price to $2.25 per pound; in February of 1943 plaintiff complied with the O.P.A. request for reduction of 3¢ per pound based upon its computation of savings due to the roll back in the ingot price of magnesium of 2¢ per pound. This price of $2.22 per pound was well below the ceiling price and far below the price charged by plaintiff's competitors in this or any other market area.

The plaintiff, in July of 1943, voluntarily reduced the price of all castings to $2.00 per pound thereby effecting a saving to its customers, for the balance of the fiscal year, of approximately $70,000.00. This saving more than offsets the amount of recovery sought by renegotiation and was made by plaintiff as a means of settling this controversy.

That on June 6, 1944, the said Robert P. Patterson, as the Under Secretary of War, acting and purporting to act by virtue of the authority delegated to him by the said Henry L. Stimson as the Secretary of War, and acting and purporting to act under said Renegotiation Act, did make an order purporting to determine excess profits alleged to have been made by plaintiff during the last eight months of its fiscal year ending November 30, 1942; that a copy of said order is attached as Exhibit A to De-

fendant's answer and by this reference incorporated herein as though set forth in full at this portion of affiant's affidavit.

That at all times herein mentioned Henry H. Arnold was and now is a duly commissioned General in the United States Army and the Commanding General of the Army Air Forces of the United States and is the same person designated in said Exhibit A as the "Commanding [32] General, Army Air Forces".

That at all times herein mentioned Brehon B. Somervell was and now is a duly commissioned General in the United States Army and the Commanding General of the Army Service Forces of the United States and is the same person designated in Exhibit A as the "Commanding General, Army Service Forces".

Affiant is informed and believes and upon such information and belief alleges the fact to be that pursuant to said Renegotiation Act the said Henry L. Stimson did, on the 30th day of June, 1942, delegate to said Robert P. Patterson, as the Under Secretary of War, all of the authority and discretion conferred upon Henry L. Stimson, as the Secretary of War; that on the 30th day of June, 1942, the said Robert P. Patterson designated the war Department Price Adjustment Board as the coordinating agency to determine and eliminate by renegotiation excessive profits and delegated to said Henry H. Arnold as the Commanding General, Army Air Forces, the authority to create certain subagencies and Price Adjustment Boards and redelegated the authority conferred by the Renegotiation Act to said Price Adjustment Boards.

That at all times herein mentioned the "renegotiations" herein referred to were conducted in the first instance by the Army Air Forces sitting in Los Angeles, California, subsequently by a Price Adjustment Board sitting in Washington, D. C., and subsequently by a Price Adjustment Board sitting in Los Angeles, California, which Boards were appointed or designated, and were and are purporting to act by virtue of authority and discretion delegated to them by said Robert P. Patterson.

That the said Robert P. Patterson, as is disclosed by Exhibit A attached to Defendant's answer, reached his conclusion through a consideration of financial operating and other data obtained from governmental or other sources unknown to plaintiff; that said Robert P. Patterson has wholly failed and neglected to [33] inform plaintiff as to what financial operating and other data he took into consideration or how he used it or what weight he gave to it; in this regard plaintiff alleges that said Robert P. Patterson and the above named Boards reached their conclusions arbitrarily, capriciously, unreasonably and in violation of plaintiff's legal rights.

That the renegotiation proceeding for plaintiff's fiscal year, November 30, 1942, was commenced on April 17, 1943, by the mailing to plaintiff of the notice attached hereto as Exhibit A; that on the date shown thereon plaintiff mailed to said Board the original of Exhibit B attached hereto, together with the data described therein; that thereafter the first conference was held concerning said renegotiation proceedings between plaintiff and said Board on May 18, 1943, as is disclosed by Exhibit C attached hereto.

The plaintiff herein has never agreed or assented to said renegotiation or the determination of any alleged excessive profits or the amount thereof but on the contrary has expressly refused to agree thereto and has at all times consistently maintained that it was not subject to said Renegotiation Act and that, in truth and in fact, it has not received or realized any excessive profits; plaintiff has consistently maintained and asserted that, as and if applied to the plaintiff or to the business or transactions of the plaintiff, said Renegotiation Act and each and every section and subdivision thereof are, and each of them is, void and unconstitutional as being unauthorized and violative of the constitution of the United States of America and that neither Henry L. Stimson, Robert P. Patterson, Henry H. Arnold nor Brehon B. Somervell had the power or authority to make said Unilateral Determination of June 6, 1944, (Exhibit A to Defendant's Answer herein), nor said direction to withhold of September 6, 1944, (Exhibit B to Defendant's Answer) or either of them and that none of said last named persons have the power or authority to enforce said Unilateral Determination according to its terms or otherwise for the reason that said [34] Renegotiation Act is unconstitutional and void, without lawful effect and repugnant to the constitution of the United States of America.

That plaintiff filed with the Tax Court of the United States its petition for redetermination of excessive profits under the Renegotiation Act on September 1, 1944, and said petition has been assigned Docket No. 61-R; that thereafter Henry L. Stimson as Secretary of War, and Robert P. Patterson as Under Secretary of War, filed their answer to said petition; that said petition is now

pending before the Tax Court of the United States but has not been calendared for hearing nor has any determination been made on its merits.

E. R. CLAYTON

Subscribed and sworn to before me this 8th day of November, 1945.

(Seal) WINIFRED HOLLAND

Notary Public in and for said County and State [35]

[EXHIBIT A]

Address Reply To:
Western District Supervisor
Attention:
Price Adjustment Sect.
File No. 1399

Budget Bureau No. 49-R070-43
Approval Expires Dec. 31, 1943

ARMY AIR FORCES
COMMAND
MATERIEL ~~CENTER~~
WESTERN PROCUREMENT DISTRICT

3636 Beverly Boulevard
Los Angeles, California
April 17, 1943

Magnesium Products, Inc.
1119 South Santa Fe Avenue
Los Angeles, California

Gentlemen:

Pursuant to an Act of Congress (Section 403 of the Sixth Supplemental National Defense Appropriation Act of 1942, approved April 28, 1942, as amended by Section 801 of the Revenue Act of 1942, approved October 21, 1942) Price Adjustment Boards have been established within the War Department, The Navy Department, the Maritime Commission, and the Treasury Department. The function of these Boards is to review the profits earned on Government business by individuals or corporations who are parties to contracts for the production or supply of war products.

In the interest of simplicity, the four above-mentioned Departments have agreed that there should be delegated to this Section all renegotiations with your Company.

It is the view of the Board that this review can better be made by an overall study of your Company's financial position and your profits (past and prospective) from your war contracts as a whole, subdivided only as to fixed-fee and fixed-price contracts, than by an analysis of each individual contract on a unit cost basis.

For preliminary study will you please send us within fifteen days:

a. Copies of your regularly prepared financial reports including balance sheets and income and surplus accounts for the years 1936 to 1942, inclusive.

b. A copy of your latest balance sheet and of your income account or operating statement for the current year to the most recent date available.

In order not to burden your company, these reports need not be set up in tabulated form. Copies of your regular audited statements with the auditor's comments, or if these are not available, your published reports to stockholders should give us all the information necessary for our preliminary study. [36]

After we have had an opportunity to study this material, it will be our purpose to arrange a meeting with you and any financial or other officers whom you may wish to include, in order that we may develop a mutually satisfactory basis for review.

It may be that a preponderant portion of your production is for some Service or Department other than the Army Air Forces. If so, we shall appreciate your advising us thereof before preparing the data requested above.

Very truly yours,

E. A. MATTISON
Major, Air Corps
Chief Price Adjustment Section

G. M. Chipman
G. M. CHIPMAN
Captain, Air Corps
Price Adjustment Section [37]

[EXHIBIT B]

May 6, 1943

Army Air Forces,
Materiel Command,
Western Procurement Dist.,
3636 Beverly Blvd.,
Los Angeles, California.

Reference:
Price Adjustment Sec.
File: 1399

Attn: Mr. J. W. Chapple

Gentlemen:

Pursuant to your letter of April 17, 1943 and our telephone conversation of this week, we are enclosing herewith, balance sheets and P and L's for the fiscal years ended November 30, 1939, 1940, 1941, 1942.

We trust that you find these satisfactory for your renegotiation purposes and we shall expect to hear from you in the near future for an appointment to go into further details.

Very truly yours,

MAGNESIUM PRODUCTS, INC.,
By E. R. Clayton
President

ERC:HH

[38]

[EXHIBIT C]

May 25, 1943.

Special Delivery

Army Air Forces
Materiel Command
Western Procurement District
3636 Beverly Blvd.
Los Angeles, California.

Reference: Price Adj. Section
File No. 1399

Attention: Mr. J. W. Chapple

Gentlemen:

As per request in Price Adj. Section Form 2, which you gave us at conference May 18th, our "Contractors Letter" is as follows:

History

In the fall of 1938, Mr. K. T. Vanganes, who had ten years prior experience in aircraft manufacture, production control and purchasing, interested the writer in the financing of our present Magnesium Products, Inc. At that time all the magnesium sand castings required for our local aircraft companies were made by the Dow Chemical Company's foundry at Bay City, Michigan, or at American Magnesium Company's foundry in Cleveland, Ohio, or at Bendix foundry at Bendix, New Jersey.

Our idea was that there could be developed sufficient aircraft and commercial business to support a local foun-

dry which would help the local manufacturers from both a price and time saving basis. We visited The Dow Chemical Company in Midland and Bay City and after proving our financial ability to perform in a manner satisfactory to them and their customers in California they granted us a license to operate a sand casting foundry and agreed to furnish us with one of their specially trained metalurgists thoroughly competent to handle any phase of any magnesium operation. The man we all agreed on was Mr. L. M. Nash who had ten years experience in all departments of their magnesium operation. Mr. Nash has been our metallurgist and general superintendent since January 1939.

At this time we asked the Dow Chemical Company for a sales contract to represent them on a manufacturers basis in California on their line of wrought magnesium products namely: sheet, extrusions, forgings and fabricated parts. The reply was that we would first have to demonstrate [39] to them that we could successfully operate a foundry and promote the sale of magnesium in this territory. About July of 1939 on inspection of our plant and operations we were awarded a sales contract on a year to year basis which we have enjoyed to the present time.

Mr. Vanganes and the writer returned from the visit to Dow in October 1938 and with my personal funds we started to purchase the necessary foundry and heat treating equipment to start operations.

The writer owns the building at 1119-1125 Santa Fe Avenue and we asked the tenant, Callahan Engineer Company to move out so that we could start the foundry operation. In using this building we acquired considerable machinery, air lines, 400 amp. electric service, overhead rail and hoist and office equipment which enabled us to get started on our small initial capital. During the first years operation we were some 10 to 12 thousand dollars in the red which was supplied by the writer on open note basis. The steady expansion which has occasioned since the first year is apparent from the statements in your possession. All capital was furnished either by the writer or from profits which we accumulated. No dividend was paid until November 1942.

We believe that we have been largely responsible for the rapid growth of the use of magnesium in this territory then our years of educational and sales promotionary work on the engineering and purchasing staffs of the local aircraft companies. We have always tried not to oversell the material and to deliver a product which was better than the specification requirement.

Thru the years we have had to anticipate the requirements of our customers to some extent, in order to be ready to turn out the necessary poundage without serious delay. The expansions required foundry production equipment such as jolt squeeze and roll over machines and heat treating equipment and the training of personnel.

A good deal of the business of 1942 and 43 was practically forced upon us, due to the opening of large branches of Douglas, North American, Boeing and Vultee in the Eastern territory. We had the only set of patterns for some of these ships and to make new patterns and prove them and secure a new source of supply would have entailed added costs and a delay of 4 to 6 months. It has been quite a struggle to keep up with the required deliveries due to this reason.

PRICE

In 1939 as far as we could ascertain the price on selective castings basis was from $2.50 to $5.00 per pound. We started on a $2.50 per pound basis and in the first year we voluntarily established for large users a price of $2.35 per pound for all castings of over 3 ounces weight. The minimum on these small castings of less than 3 ounces 55c each. About 1940 we voluntarily established a "Blanket Price" of $2.35 for large accounts. This had the effect of saving large amounts of time formerly consumed both by our own cost and billing departments and by the aircraft companies cost [40] accounting and estimating departments. About 1941 we voluntarily reduced the blanket price to large users to $2.30. Another voluntary reduction to $2.25 followed about January 1942. On February 1st of 1943 we complied with the O.P.A. request for a reduction of 3¢ per pound based on their computation of savings due to the reduction in ingot price of 2¢ per pound.

COOPERATION

We have during our entire history cooperated with our competitors in sharing with them the knowledge and designs for special equipment necessary to turn out a satisfactory product. This is proven by the fact that with the exception of the local American Magnesium Plant all the men in charge of our competitors' foundries were exemployees of this company at one time and were trained under our system by Mr. Nash. Many of their molders, coremakers, heat treaters and finishers had this training in our plant. During the 1942 shortage of materials we, on many occasions, kept local plants open by loaning them from our stocks magnesium ingot, melting fluxes, crucibles and other materials. These loans were on a free basis and all that we received was the return of the same amount of material. We have been instrumental in reducing the cost to all of us on melting crucibles from $35.00 in 1939 to $10.00 at present.

FUTURE OPERATIONS

We are of the opinion that magnesium is in its infancy, that it is hazardous and we believe we would never have crowded the large amount of production equipment into our small plant except for the urgent needs of war necessity. We believe that it will not be possible to operate on our present three shift six day basis economically in the post war era. We will have considerable amounts of excess machinery for which we do not hold a certificate of necessity. For these reasons we believe

that our present operations are of the so called "War Baby" Class and should be entitled to a larger percentage of profit than more stable established lines.

In December 1942 we suffered a disastrous fire which destroyed our entire cleanup and shipping department just completed in August 1942. This represents about 20% of our entire floor space. We only lost three days operation in the foundry and sub-contracted the cleanup work. We had the building entirely rebuilt and new machinery in operation in exactly 30 days time. In the next 60 days we caught up and passed the entire production lost in December.

Trusting this is the information desired and assuring you or our continued cooperation, we are

Very truly yours,

MAGNESIUM PRODUCTS, INC.
By E. R. Clayton
President [41]

ERC:HG

Received copy of the withn. Flint & Mackay, Nov. 17, 1945. By L.K.

[Endorsed]: Filed Nov. 19, 1945. [42]

[Title of District Court and Cause]

RESPONSE TO CERTIFICATION AND MOTION BY UNITED STATES TO INTERVENE

Comes now the United States of America by its Assistant Attorney General, John F. Sonnett, and its attorney for the Southern District of California, Charles H. Carr, and says:

1. The United States of America, pursuant to the Act of August 24, 1937 (28 U. S. C. 401) and Rule 24 of the Federal Rules of Civil Procedure, moves to intervene and become a party herein for the purposes and with all the rights provided by said Act of August 24, 1937, and by said Rule 24, on the following grounds:

(a) That the constitutionality of an Act of Congress, the [43] Renegotiation Act, [Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942 (Public 528, 77th Congress), approved April 28, 1942, as amended by Section 801 of the Revenue Act of 1942 (Public 753, 77th Congress) approved October 21, 1942; by the Military Appropriation Act, 1944 (Public 108, 78th Congress), approved July 1, 1943; by Public 149, 78th Congress, approved July 14, 1943; and as amended in full by Section 701 (b) of the Revenue Act of 1943 (Public 235, 78th Congress, enacted February 25, 1944] affecting the public interest is drawn in question in this action and neither the United States, nor any agency

thereof, nor any officer or employee thereof, as such officer or employee, is a party hereto; and

(b) That in accordance with Rule 24 (b) (2) of the Federal Rules of Civil Procedure, the United States has claims and defenses which present questions both of law and of fact which are common to the main action. The intervention of the United States will not unduly delay or prejudice the adjudication of the rights of plaintiff or defendant in this action.

2. Annexed hereto in accordance with Rule 24 (c) of the Federal Rules of Civil Procedure is a pleading entitled "Answer of the United States." The United States moves that said pleading be deemed the appearance of the United States in support of the constitutionality of the Act of Congress herein drawn in question, and in opposition to all pleadings, motions, and proceedings of the parties hereto that have been or may be made in so far as said pleadings, motions, or proceedings are based on the contention that said Act of Congress is in any respect, or in any application, unconstitutional; and that said pleading be deemed the appearance of the United States for the purpose of asserting its claims and defenses under the Federal Rules of Civil Procedure, and in opposition to all pleadings, motions, and proceedings of the parties hereto that have been made or may be made herein in so far as said pleadings, motions, or proceedings relate to said claims or defenses.

3. The United States moves for leave to make such motions [44] and take such other proceedings as it may deem appropriate or desirable and to present evidence in support of the allegations of its answer and as the Act of August 24, 1937 provides.

JOHN F. SONNETT
Assistant Attorney General

CHARLES H. CARR
United States Attorney

RONALD WALKER
Assistant United States Attorney

ROBERT E. WRIGHT
Assistant United States Attorney

Attorneys for United States

[Endorsed]: Filed Jan. 18, 1946. [45]

[Title of District Court and Cause]

NOTICE

To: Rufus Bailey, Arlo D. Poe, 639 South Spring Street, Los Angeles 14, California, Attorneys for Plaintiff.

To: Flint & Mackay, 12th Floor Rowan Building, 458 South Spring Street, Los Angeles, California, Attorneys for Defendant, North American Aviation, Inc.

You Will Please Take Notice that on Monday, the 28th day of January, 1946, at the hour of 10:00 o'clock in the forenoon of said day or as soon thereafter as counsel may be heard, the undersigned attorneys for the United States of America will appear before the [46] Honorable J. F. T. O'Connor in the Courtroom usually occupied by him in the United States Court House, Los Angeles, California, and will then and there present the motion of the United States for leave to intervene in the above-entitled cause, the answer of the United States, as intervenor, to the complaint in said cause, and will then and there move the Court to enter an order allowing intervention by the United States, copies of which said motion, answer, and proposed order are attached hereto.

JOHN F. SONNETT
Assistant Attorney General
CHARLES H. CARR
United States Attorney
RONALD WALKER
Assistant United States Attorney
ROBERT E. WRIGHT
Assistant United States Attorney
Attorneys for United States

[Endorsed]: Filed Jan. 18, 1946. [47]

[Title of District Court and Cause]

ORDER ALLOWING INTERVENTION BY UNITED STATES

This cause came on to be heard on the motion of the United States to intervene and for other relief, and the Court being satisfied that the United States has the right to intervene and become a party herein under the provisions of the Act of August 24, 1937 (28 U. S. C. 401), and under the provisions of Rule 24 of the Federal Rules of Civil Procedure.

It Is Ordered:

1. That the motion of the United States is in all respects granted;

2. That the United States is hereby made a party to this [49] cause for the purposes and with all the rights provided by said Act of August 24, 1937, and by the Federal Rules of Civil Procedure, and that the United States shall receive notice of all proceedings herein;

3. That the Answer of the United States, annexed to said motion, is deemed the appearance of the United States in support of the constitutionality of the Act of Congress herein drawn in question, to wit, the Renegotiation Act; and in opposition to all pleadings, motions, and proceedings of the parties hereto that have been or may be made in so far as said pleadings, motions, or proceedings are based on the contention that said Act of Congress is in any respect, or in any application, unconstitutional; and that such Answer of the United States is deemed the appearance of the United States for the purpose of asserting its claims and defenses under Rule 24 (b) (2) of the

Federal Rules of Civil Procedure; and in opposition to all pleadings, motions, or proceedings of the parties hereto that have been made or may be made herein in so far as said pleadings, motions, or proceedings relate to said claims or defenses;

4. That leave is granted to the United States to make such motions and take such other proceedings as it may deem appropriate or desirable and to present evidence at the trial in support of the allegations of its answer and in the manner provided by said Act of August 24, 1937.

Done in open Court this 28 day of January, 1946.

J. F. T. O'CONNOR
United States District Judge

[Endorsed]: Filed Jan. 28, 1946. [50]

[Title of District Court and Cause]

ANSWER OF THE UNITED STATES

The United States of America, intervenor herein, for its pleading in intervention alleges as follows:

1. By certificate dated November 19, 1945, the Honorable J. F. T. O'Connor, Judge of the United States District Court, certified to the Attorney General, pursuant to the Act of August 24, 1937 (28 U. S. C. 401), the fact that the constitutionality of the Renegotiation Act, an Act of Congress affecting the public interest, is drawn in question in this action.

2. Except by this intervention neither the United States nor any agency thereof nor any officer or employee thereof, as such officer [51] or employee, is a party to this action.

3. The Renegotiation Act affects the public interest for the following reasons among others:

(a) In the light of the experience acquired in the Revolutionary War, the Civil War and the World War, Congress concluded that the Renegotiation Act is the fairest and most effective method for eliminating excessive war profits.

(b) Effective control of war profits is an essential feature of a successful war program. The control of war profiteering is required to maintain morale, reduce the tax burden, control inflation, and stimulate efficient procurement practices.

(c) The United States has obtained refunds pursuant to the Renegotiation Act of excessive war profits in an amount greater than $6,000,000,000, prior to tax adjustment. In 97.5% of the cases the contractor agreed to the determination made by the renegotiating officials.

FIRST DEFENSE

4. The Renegotiation Act was enacted pursuant to the war powers of Congress. It is constitutional and valid and all action taken pursuant thereto in determining the amount of excessive profits realized by plaintiff was in all respects lawful.

5. The Declarations of War with Germany, Italy, and Japan required the production of the weapons of war, the procurement of equipment and supplies for troops, the construction of camps and camp facilities and the procurement of the instruments of communication and transportation in the largest possible quantity with the greatest possible speed. The full industrial capacity of the United

States had to be converted immediately to the production of war material and to meet war objectives. The extent of the procurement problem is indicated by the fact that during the four months of July, August, September, and October, 1942, the War Department alone entered into over 1,400,000 contracts. In January, 1942, the total dollar value of contracts executed for war [52] purposes amounted to more than $9,000,000,000 and in the remaining months of the fiscal year 1942 this figure never fell below $4,800,000,000. On June 30, 1942, the outstanding obligations of the United States for war supplies and war facilities amounted to nearly $43,000,000,000. Total expenditures of the War and Navy Departments for the fiscal year ending June 30, 1942, amounting to nearly $23,000,000,000, exceeded the total military and naval expenditures of the United States from 1789 through the end of the World War.

6. The necessity for procuring war material adequate in quantity and available in time to permit this nation to avert grave military reverses required that ordinary procurement procedures be drastically modified. Negotiation of contracts was substituted for advertising for bids; letters of intent and letter contracts were widely employed to allow manufacturers to begin production prior to the execution of formal agreements; subcontracting and widespread distribution of war orders were required to utilize the full industrial capacity of the nation and procurement officials in the field were given full and final authority to execute contracts in very large amounts. The difficulties were enormously increased by the fact that modern warfare, mechanized and amphibious, has forced the development, production, and use of hitherto unknown weapons

and supplies. Furthermore, shortages and dislocation of labor and materials required wholesale revisions in established methods of production.

7. Under these circumstances accurate pricing was impossible. Many of the supplies and weapons were entirely new and as to these there was and could be no guiding cost or price experience. Many contractors were required to produce articles which they had never produced before and were thus required to convert their plants and to retrain their labor forces. Quantities, rates of delivery, and specifications were and had to be modified in the light of battle experience. These uncertainties were further increased by shortages and dislocation of labor and material supply. Under such circumstances, the contractor [53] was entitled to and did receive prices which would protect him against these innumerable hazards to production, although it was recognized that as experience was acquired, as conversion problems were solved, as labor was trained, as lines of supply were established, as design and specifications were crystallized, and as mass production was achieved, the cost of production would be greatly decreased and, therefore, that very large profits could be expected.

8. Renegotiation developed as the solution to the problem of meeting the procurement needs of the armed forces with the speed necessary to achieve military objectives, and at the same time eliminating excessive war profits which would place an undue burden upon the taxpayers of the nation, impair the national morale, and constitute a threat of war-time inflation. Prior to the enactment of the statute there had been numerous instances of voluntary

refunds to the Government of excessive profits and of voluntary renegotiation and revision of contract prices. The War and Navy Departments had, prior to the statute, established cost inspection divisions and had designated renegotiating officials whose duty it was to advise contracting officers concerning fair pricing for future contracts and to renegotiate prices under existing agreements. The Renegotiation Act made obligatory and gave the force of law, with power in the Government to make unilateral determinations and with such other modifications as the Congress thought desirable, to the practice which was developed by the Services and responsible members of the business community.

9. No rigid definition of excessive profits are possible. In fairness to the contractor and to the public, it was necessary that the ultimate price and the ultimate profit be fixed by an exercise of judgment in the light of the conditions peculiar to the individual contractor. Consideration had to be given to a great variety of circumstances, including the contractor's economy in the use of labor, plant facilities and raw materials, the contractor's efficiency in achieving quantity production at reduced cost, the war contribution of the contractor by invention [54] or by development of manufacturing technique, the quality and complexity of the item produced, the extent and character of subcontracting, the nature and amount of Government financing, the contractor's cooperation in meeting the changing problems of war production, the risks assumed by the contractor because of close pricing, large inventories, cut-backs in orders or modifications of specifications and such other factors as might at the time of the profit determination prove to be appropriate.

10. In order to achieve the purposes for which the statute was passed and to eliminate, so far as possible, unfair discrimination between contractors the Congress determined that it was necessary that the Act apply to contracts in existence on the date the legislation became effective, that is on April 28, 1942. On that date there were outstanding uncompleted war contracts under which the United States had obligations in excess of $50,000,000,000. It was in connection with these early contracts that the probability of excessive profits was greatest and accordingly, that the need for renegotiation was greatest.

11. All the considerations which required renegotiation of prices and profits arising from prime contracts apply with equal force to subcontracts.

12. In view of the great variety of war contracts and in order that the accounting burden might not defeat the ultimate objectives of the statute and in order that the renegotiation law itself should not by its rigidity impede the procurement of war supplies, it was necessary and advisable that the procuring agencies be empowered to act upon the classification of contracts established by the statute.

SECOND DEFENSE

13. This Court has no jurisdiction of any issue as to which the Tax Court is given jurisdiction by Section 403 (e) of the Renegotiation Act. That section permits any contractor or subcontractor dissatisfied with the administrative determination of his excessive profits to obtain [55] in the Tax Court of the United States a determination de novo of the amount of such profits and the Tax Court is given "exclusive jurisdiction, by order, to

finally determine the amount, if any, of such excessive profits received or accrued by the contractor or subcontractor, and such determination shall not be reviewed or redetermined by any court or agency." Plaintiffs have filed a petition in the Tax Court for such redetermination but the Tax Court has not as yet heard or decided plaintiff's case. This suit is premature because plaintiff has not as yet exhausted its Tax Court remedy.

THIRD DEFENSE

14. The complaint fails to state a claim upon which relief can be granted.

FOURTH DEFENSE

15. (a) The United States admits the allegations of paragraphs I and II of the complaint.

(b) During 1942, plaintiff was engaged in the manufacture of certain magnesium castings, all of which had a war end use. These magnesium castings were sold to defendant North American and others, and as plaintiff well knew they were used in the fabrication of aircraft and aircraft parts manufactured for and at the expense of the United States. After the enactment of the Renegotiation Act on April 28, 1942, plaintiff continued to enter into numerous purchase order contracts for the manufacture and sale of such castings and to make deliveries pursuant to those purchase orders.

(c) After due notice to plaintiff, proceedings for the renegotiation of plaintiff's contracts and subcontracts were had and conducted by representatives of the Secretary of War and thereafter, and on the 6th day of June, 1944, the Under Secretary of War, acting under and by virtue of

the Renegotiation Act and pursuant to authority delegated to him, duly determined, in accordance with law, that of the profits realized by plaintiff during its fiscal year ending November 30, [56] 1942 on its contracts and subcontracts subject to renegotiation, $250,000 thereof were excessive profits. A full, true and correct copy of the order and determination of the Under Secretary of War is attached hereto as Exhibit "A" and by this reference made a part hereof.

(d) The tax credit to which plaintiff is entitled under Section 3806 of the Internal Revenue Code is in the amount of $184,376.63. This tax credit is computed upon the assumption that the profits determined to be excessive were returned as income by plaintiff for tax purposes and that the appropriate taxes have been or will be paid on such profits.

(e) On or about September 6, 1944, the Under Secretary of War mailed to defendant North American a "Direction to Withhold from Magnesium Products, Inc., of Los Angeles, California, pursuant to the Renegotiation Act." This withholding order was amended by a telegram from the Under Secretary of War to defendant North American, dated October 14, 1944, by a further telegram dated October 19, 1944, and by a letter dated July 21, 1945. Full, true, and correct copies of the order and its amendments are attached hereto as Exhibits "B", "C", and "D", and "E", and by this reference made a part hereof.

(f) The United States is informed and believes, and upon such information and belief alleges that pursuant to these directions from the Under Secretary of War defendant North American has withheld for the account

of the United States, from amounts otherwise due to plaintiff, the sum of $20,204.03. And the United States further alleges that by reason of the orders and determinations made by the Under Secretary of War and described herein said sum of $20,204.03 is not now owing to plaintiff but is owing to the United States.

(g) Plaintiff has filed a petition in the Tax Court of the United States asking for a redetermination of the amount, if any, of its excessive profits for its fiscal year ending November 30, 1942. The Tax Court has not as yet heard plaintiff's case or rendered any [57] decision thereon.

(h) The United States denies each allegation of the complaint not admitted, qualified, or specifically denied.

16. With respect to all matters in controversy in this suit, all action taken by Henry L. Stimson and Robert P. Patterson and by all persons acting for them or under their direction or on their behalf, was taken pursuant to and authorized or required by the Renegotiation Act.

FIFTH DEFENSE

17. The United States by this reference realleges as though fully here set forth each of the allegations contained in paragraphs 1 to 16, inclusive, of this answer.

18. By reason of the facts and circumstances set forth in this fifth defense, plaintiff has waived all right to contest the validity of the Renegotiation Act or the validity of the orders, directions and determinations of the Under Secretary of War, and all right to contend that there is any indebtedness owing to plaintiff from defendant North American.

SIXTH DEFENSE

19. The United States by this reference realleges as though fully here set forth each of the allegations contained in paragraphs 1 to 16, inclusive, of this answer.

20. By reason of the foregoing fact and circumstances set forth in this sixth defense, plaintiff is estopped from contesting the validity of the Renegotiation Act or the validity of the orders, directions and determinations of the Under Secretary of War, and from asserting that there is any indebtedness owing to plaintiff from defendant North American. [58]

SEVENTH DEFENSE

21. The United States by this reference realleges as though fully here set forth each of the allegations contained in paragraphs 1 to 16, inclusive, of this answer.

22. By reason of the foregoing facts and circumstances set forth in this seventh defense and because the Renegotiation Act has to do with the expenditure of the funds of the Federal Government, the matters in controversy in this answer are matters over which the executive and legislative branches of the Government have full, final, and exclusive authority.

For Answer to the Second and Separate Cause of Action in the Complaint, the United States Admits, Denies, and Alleges as Follows:

23. The United States incorporates herein and by this reference realleges as though fully here set forth each and all of the allegations heretofore set forth in this answer.

Wherefore, the United States prays that the Court adjudge and declare that the Renegotiation Act is constitutional and that the United States have such other and further relief as to the Court shall seem just and proper.

JOHN F. SONNETT
Assistant Attorney General
CHARLES H. CARR
United States Attorney
RONALD WALKER
Assistant United States Attorney
ROBERT E. WRIGHT
Assistant United States
Attorney [59]

EXHIBIT "A"

WAR DEPARTMENT
OFFICE OF THE UNDER SECRETARY
Washington

DETERMINATION OF EXCESSIVE PROFITS

Pursuant to Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, which term refers to said Act as last amended 14 July 1943 and as affected by Title VII of the Revenue Act of 1943 so far as applicable.

Whereas, Magnesium Products, Inc., (hereinafter referred to as the Contractor) holds contracts and subcontracts subject to renegotiation pursuant to the provisions of Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended (hereinafter referred to as the Act); and

Whereas, renegotiation has taken place between the Under Secretary of War and the Contractor, pursuant to the provisions of the Act, for the purpose of eliminating excessive profits realized by the Contractor during its fiscal year ended 30 November 1942, under said contracts and subcontracts; and

Whereas, as a basis for said renegotiation the Under Secretary of War considered certain financial, operating and other data, submitted by the Contractor or obtained by the Under Secretary of War from governmental or other reliable sources, relating to the profits realized by the Contractor during said fiscal year under said contracts and subcontracts; and

Whereas, the Contractor has been granted full opportunity to submit such additional information and to present such contentions as the Contractor deemed material in determining the excessiveness of said profits and the renegotiability of such contracts and subcontracts, at hearings of which due notice was given, and due consideration has been given to the financial, operating and other data and information so furnished or obtained and each of the contentions so presented;

Now, Therefore, pursuant to the authority and discretion vested in the Secretary of War, the Secretary of the Navy, the Secretary of the Treasury, the Chairman of the Maritime Commission, the Administrator of the War Shipping Administration, and the respective Boards of Directors of the Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation and Rubber Reserve Company under the provisions of the Act, and duly delegated to the Under Secretary of War under

subsection (f) thereof, it is hereby found and [60] determined:

That $250,000 of the profits realized by the Contractor during its fiscal year ended 30 November 1942, under its contracts and subcontracts subject to renegotiation pursuant to the provisions of the Act, are excessive.

That in connection with the payment or discharge by means of the amount of excessive profits determined hereby to have been realized by the Contractor, the Contractor shall be credited with any amount to which it may be entitled under Section 3806 of the Internal Revenue Code as computed by the Commissioner of Internal Revenue.

That the Contractor is directed to repay such excessive profits less such tax credit, if any, to the Treasurer of the United States.

That the excessive profits so found and determined shall be eliminated by any of the methods provided in the Act or any combination thereof; and the Commanding General, Army Service Forces, and the Commanding General, Army Air Forces, are hereby authorized and directed to take any and all action which may be necessary or desirable to effect such elimination.

6 June 1944

(S) ROBERT P. PATTERSON
Robert P. Patterson
Under Secretary of War

SPRAR-8
5-17-44 Copy 24-55147 [61]

EXHIBIT "B"

SPRAR 6 September 1944.
North American Aviation, Inc.,
Inglewood, California

Subject: Direction to Withhold from Magnesium Products, Inc., of Los Angeles, California, pursuant to the Renegotiation Act.

Gentlemen:

Pursuant to the authority vested in the Secretary of War under Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, and duly delegated to me, I found and determined on 6 June 1944 that certain of the prices and profits realized by Magnesium Products, Inc., during its fiscal year ended 30 November 1942 under contracts and subcontracts subject to renegotiation were excessive.

In accordance with the authority and duty to eliminate said excessive profits (after allowing to said Magnesium Products, Inc. credit for Federal taxes and provided in Section 3806 of the Internal Revenue Code) I hereby direct you to withhold for the account of the United States any and all amounts (not in excess of $40,000 in the aggregate) otherwise due or which shall become due from you to said Magnesium Products, Inc.

This direction shall be effective immediately and shall continue in effect until further notice from me.

You are also directed to report in writing to the Chairman of the War Department Price Adjustment Board, Room 3D 573, The Pentagon, any amounts which you

may from time to time withhold for the account of the United States pursuant hereto.

Very truly yours,

ROBERT P. PATTERSON
Under Secretary of War

FF:hhb Copy [62]

EXHIBIT "C"

72867

ASF, PRICE ADJUSTMENT BOARD RENEGOTIATION DETERMINATION SPRAR ROOM 3D 573, THE PENTAGON, WASHINGTON 25, D. C.

NORTH AMERICAN AVIATION, INC.
INGLEWOOD
CALIFORNIA 14 OCTOBER 1944

MY LETTER 6 SEPTEMBER 1944 DIRECTING YOU TO WITHHOLD $40,000 FROM MAGNESIUM PRODUCTS, INC. FOR ACCOUNT THE UNITED STATES IS HEREBY AMENDED AS FOLLOWS:

YOU ARE TO CONTINUE TO WITHHOLD SUCH AMOUNTS AS WERE OTHERWISE DUE FROM YOU TO MAGNESIUM PRODUCTS, INC. AT THE CLOSE OF BUSINESS ON 14 OCTOBER 1944 WHICH AMOUNTS I UNDERSTAND TOTAL NOT LESS THAN $24,462.24.

YOU ARE TO WITHHOLD NO ADDITIONAL AMOUNTS UNTIL 30 OCTOBER 1944 ON WHICH DATE YOU ARE TO RESUME WITHHOLDING IN ACCORDANCE WITH MY LETTER OF 6

SEPTEMBER 1944 UNTIL THE TOTAL OF AMOUNTS WITHHELD THROUGH 14 OCTOBER 1944 AND AFTER 30 OCTOBER 1944 IS $33,500.

ROBERT P. PATTERSON
UNDER SECRETARY OF WAR

OFFICIAL
G. K. HEISS
COLONEL, ORDNANCE DEPARTMENT
EXECUTIVE ASSISTANT

DRStuart; fm COPY [63]

EXHIBIT "D"

19 OCTOBER 1944
72868

ASF, PRICE ADJUSTMENT BOARD RENEGOTIATION DETERMINATION SPRAR ROOM 3D 573, THE PENTAGON, WASHINGTON 25, D. C.

NORTH AMERICAN AVIATION, INC.
INGLEWOOD
CALIFORNIA

REFERENCE YOUR TELEGRAM 17 OCTOBER FROM JOHNSON STOP MY TELEGRAM 14 OCTOBER RESPECT TO MAGNESIUM PRODUCTS, INC. WITHHOLDING IS HEREBY AMENDED TO REFER TO TOTAL OF NOT LESS THAN $16,866.43 IN LIEU OF $24,462.24 STOP RESPECT COD DELIVERY REFERENCE IS MADE TO LET-

TER DATED 13 OCTOBER FROM MAGNESIUM PRODUCTS, INC. RUFUS BAILEY, SECRETARY, TO DEPARTMENT OF JUSTICE WHICH AGREES THAT DURING PERIOD BETWEEN 13 OCTOBER AND 30 OCTOBER SALES TO YOU WILL BE ON QUOTE CUSTOMARY CREDIT TERMS UNQUOTE END

ROBERT P. PATTERSON
UNDER SECRETARY OF WAR

OFFICIAL:

G. K. HEISS
COLONEL, ORDNANCE DEPARTMENT
EXECUTIVE ASSISTANT
DRStuart; fm COPY [64]

EXHIBIT "E"

SPFEU 167/490428 Magnesium Products Inc.

21 July 1945

North American Aviation, Inc.
Inglewood, California

Gentlemen:

Receipt is acknowledged of your letter dated 6 July 1945, in which you state that you have withheld from Magnesium Products Company, 1119 South Santa Fe Avenue, Los Angeles 21, California, as of that date the sum of twenty thousand two hundred four dollars and

three cents ($20,204.03), pursuant to the withholding directive of the Under Secretary of War.

Reference is made to withholding order dated 6 September 1944, whereby you were directed by the Under Secretary of War, to withhold monies otherwise due Magnesium Products Company in an amount not to exceed forty thousand dollars (40,000), as amended. Such withholding order is hereby further amended in that the maximum amount to be withheld from Magnesium Products Company is decreased from forty-thousand dollars (40,000) in the aggregate to twenty thousand two hundrew four dollars and three cents (20,204.03) in the aggregate.

It is now requested that you continue withholding the twenty thousand two hundred four dollars and three cents (20,204.03), until further advice is received from this office as to disposition to be made of the amount withheld.

This office appreciates your cooperation in the matter.

Sincerely yours,

R. P. HUEPER
Brigadier General, USA
Acting, Fiscal Director

COPY

[Endorsed]: Filed Jan. 18, 1946. [65]

[Title of District Court and Cause]

MOTION FOR SUMMARY JUDGMENT

Comes now the intervenor, the United States of America, and moves for summary judgment on the ground that there is no genuine issue as to any material fact and the intervenor is entitled to judgment as a matter of law, and on the further ground that the complaint fails to state a claim upon which relief can be granted. The Court has no jurisdiction in this action of any issue as to which the Tax Court of the United States has jurisdiction under the provisions of the Renegotiation Act.

This motion is based upon the answer of the United States, the [66] affidavits filed in support of this motion, and upon the pleadings, files, and records in this case.

JOHN F. SONNETT
Assistant Attorney General

CHARLES H. CARR
United States Attorney

RONALD WALKER
Assistant United States Attorney

ROBERT E. WRIGHT
Assistant United States Attorney

[Endorsed]: Filed Jan. 28, 1946. [67]

[Title of District Court and Cause]

AFFIDAVIT OF H. STRUVE HENSEL

City of Washington,
District of Columbia, ss:

H. Struve Hensel, being first duly sworn, deposes and says:

1. I have been Assistant Secretary of the Navy since January 30, 1945. The Secretary of the Navy has delegated to me, as Assistant Secretary, the general supervision over all of the procurement activities of the Department of the Navy. I was appointed a Special Assistant to the Under Secretary of the Navy in January 1941 and was appointed Chief of the Procurement Legal Division upon the formation of that Division in July 1941. When the name of the Procurement Legal Division was changed to the Office of the General Counsel for the Department of the Navy in August 1944, I was appointed General Counsel which position I held until my appointment as Assistant Secretary. As Chief of the Procurement Legal Division and General Counsel, I had general supervision over all of the procurement legal matters in the Department of the Navy and supervised the drafting of Navy contracts.

2. The statements made in this affidavit are based upon information received by me in my official capacity and which I believe to be true and accurate.

I. SCOPE AND COMPLEXITY OF NAVY PROCUREMENT.

3. The armed services in December 1941 were faced with procurement problems on a scale beyond anything which they had theretofore experienced. The problems of allocating materials and manpower were enormous. The Army and Navy urgently needed ships, planes, tanks and other munitions of every kind, regardless of cost. The logistics requirements had changed so much and so swiftly with the outbreak of war that the available data on the Government's [69] previous procurement were of very little assistance in fixing prices which would closely reflect the ultimate costs.

4. Prior to the emergency period, all Navy contracts were let as the result of competitive bidding. The first step away from this requirement was taken in the Act of April 25, 1939, when the Congress authorized construction of naval facilities on island bases on a cost-plus-a-fixed-fee basis. In the next fifteen months several further authorizations were enacted allowing the negotiation of cost-plus-a-fixed-fee contracts for construction.

5. The first major expansion in the Navy's war-procurement planning was in June 1940. Upon the fall of France and the Low Countries, the Congress voted to make substantial additions to the United States Fleet. By December 1941, Navy procurement programs had been accelerated as demands from the Fleet became more imperative. After December 7, 1941, the procurement tempo sky-

rocketed. So many different items were needed in such large quantities, by both the War and Navy Departments, that the Navy Department felt compelled to give a commitment to almost any manufacturer who demonstrated ability to perform the work.

6. In June and July, 1940, the authorized strength of the Navy was approximately doubled. The "11 percent Expansion Act" of June 14, 1940 and the "70 percent Expansion Act" of July 19, 1940 (the Two-Ocean Navy Act) were passed in recognition of the threats to this nation's security implicit in the German victories. These authorizations of increased Navy strength were accompanied by grants of contract authority and the necessary appropriations. The Act of June 28, 1940 (Public No. 671, 76th Congress) granted limited authority to negotiate contracts for vessels, propulsion machinery and equipment, and also [70] granted the necessary authority to construct facilities to build the vessels and munitions. Requests to the Congress for authority to negotiate contracts had emphasized that the Navy had need for utilizing the services of all shipbuilders, all manufacturers of naval ordinance and other munitions, rather than the services of only those making the lowest bids. In point of fact, the contracts let by the Bureau of Ships in late 1940 and the first half of 1941 to carry out the additions to the Fleet authorized by the Congress, in large part tied up the existing naval shipbuilding capacity of the nation. Although new shipbuilding facilities were being constructed and completed throughout the last half of 1940

and 1941, it was not until early 1942 that the completion of vessels on the ways and the availability of the new shipbuilding facilities made possible the execution of another large group of shipbuilding contracts.

7. The vastness of the procurement programs in 1941 and the early part of 1942, as compared with earlier programs, tended to subordinate all other considerations to the single factor of getting the munitions. The Navy did not during this period have any mechanisms for determining close contract prices or for controlling profits under its contracts. More important, neither the Navy personnel responsible for procurement nor the contractors had any experience to enable them to gauge profits accurately. Many contractors were making new items which had never before been manufactured in this country. Manpower problems began to be acute with the acceleration of inductions under the Selective Service Act. No one had any idea as to what effect manufacture of ordnance and other items by the thousands instead of by single items or in small lots would have on profits. It proved generally impossible to make allowance in [71] advance for increased efficiency gained from experience, and the greater profits, resulting from increased volume. In instance after instance the Navy found that costs and profits seemingly reasonable at the start of the contract became unreasonable after volume and experience had increased. The important contracts were so large that a small margin of error in computing prices could wipe out the contractor's capital. Conversely, allowances for con-

tingencies, intended only for protection, often turned into unexpected profits. Finally, Navy personnel during this period were more interested in getting the munitions than in limiting profits under the contracts for such munitions.

a. Contract Statistics

8. The scope of the problem of acquiring naval supplies and equipment at reasonable prices can be discovered by examination of some Navy statistics for this period.

i. Commitments and expenditures

9. For the calendar years 1940-1944, the Navy's commitments and expenditures of appropriated funds were as follows (in billions of dollars):

	Fiscal 1940	Fiscal, 1941		Fiscal, 1942		Fiscal, 1943		Fiscal, 1944	
	7-1-39 to 6-30-40	7-1 to 12-31-40	1-1 to 6-30-41	7-1 to 12-31-41	1-1 to 6-30-42	7-1 to 12-31-42	1-1 to 6-30-43	7-1 to 12-31-43	1-1 to 6-30-44
mitments	$1.1	8.5	4.2	6.0	17.2	13.8	13.0	12.2	12.0
enditures	.....	0.9	1.7	2.8	6.2	7.6	13.8	12.2	14.9

The commitments represent roughly the amount of contract obligations (including letters of intent) executed; plus amounts for pay, subsistence and transportation of naval personnel (for the fiscal years 1941 to 1944, inclusive, expenditures for these purposes, in billions of dollars, were 0.32, 0.65, 2.01 and 4.8, respectively). It will be noted that *commitments* in the first [72] half of 1942 almost tripled those of the latter half of 1941, and that *expenditures* in the first part of 1942 were more than double those of the earlier period. Furthermore, both

commitments and expenditures for the second half of 1941 had gone up very considerably over those of the first half of 1941.

ii. Number and size of contracts

10. The following figures indicate the vast increase in procurement contracts during the months of the fiscal year 1942 beginning July 1, 1941 up through April 30, 1942. The figures include all new work awarded, consisting of all new contracts, letters of intent and extensions of existing contracts. Letters of intent were the informal (but nonetheless binding) contracts awarded to a manufacturer in order to authorize him to get started on the work in advance of the time when detailed contract terms or prices could be worked out. They were often used when specifications were not completed, when it was necessary to finance the contractor immediately, or when the detailed terms—including often intricate payment provisions and delivery schedules—might take a long time to negotiate.

($1,000,000's)

	1941						1942			
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	
Total dollar amount of awards	$662.8	342.1	565.6	414.1	487.1	1,026.3	1,372.9	2,927.5	2,202.9	1
Expenditures	.....	.....	.....	$450	400	700	600	700	1,100	1
Total number of awards over $50,000	541	473	434	587	604	749	1;083	1,085	1,344	1

11. The above figures are further broken down by Bureaus as follows:

($1,000,000's)

	1941						1942			
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.
contracts (signed Secretary—primar- facilities, vessels)										
ount	$73.6	40.0	121.8	79.9	4.9	50.0	37.9	6.3	10.1	33.7
er $50,000	32	31	40	26	7	23	21	15	15	38
Ord Contracts (BuOrd)										
ount	$12.3	23.7	13.2	11.0	61.5	27.2	58.7	35.9	99.4	138.4
er $50,000	8	9	8	22	36	26	25	27	70	87
NXs Contracts (BuSandA)										
ount	$306.3	247.2	372.8	228.7	281.8	724.0	747.7	2,344.4	1,254.5	1,135.5
er $50,000	351	340	318	404	362	477	670	657	735	1,070
Oy Contracts (BuY&D)										
ount	$264.4	25.9	55.4	100.3	110.4	101.4	143.4	145.1	184.2	131.5
er $50,000	128	66	80	120	167	180	230	251	380	326
Obs Contracts (BuShips)										
ount	.....	.....	.....	$0.9	5.5	119.5	361.7	315.8	628.4	230.8
er $50,000	.....	.....	.....	2	15	26	61	78	96	116
Contracts (Bu- —only facilities)										
ount	.....	.....	.....	.....	$21.6	2.9	5.4	71.3	21.0	66.1
er $50,000	.....	.....	.....	.....	11	4	14	20	27	26
Om Contracts Marine Corps)										
ount	$6.2	5.4	2.4	2.2	1.6	4.3	18.2	8.7	5.1	9.4
er $50,000	22	27	8	13	6	13	56	37	21	55

Throughout this ten-months' period, the Bureau of Supplies and Accounts executed all contracts for the articles specified by the Bureau of Aeronautics (except facilities) and for a great many of the articles specified by the other Bureaus. In September and October 1941, the Secretary delegated his power to execute negotiated contracts to the Chiefs of the several Bureaus; this fact accounts for the change in distribution of the contracts awarded following such months. [74]

iii. Decline in use of competitive bids

12. The following table shows the predominance of the negotiated contract as compared with contracts let after competitive bids during the period in question:

($1,000,000's)

	1941						1942		
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
Competitive bids	$96.9	78.4	88.9	87.5	101.1	121.8	112.1	73.7	67.9
Negotiated contracts including letters of intent and extensions of existing contracts)	$505.1	250.0	457.1	311.4	362.0	869.2	1,222.6	2,803.2	2,112.6

Under the old competitive bid contract, used prior to the emergency, there was almost no pricing problem—the contract was awarded to the lowest bidder. It is true that a modified system of competitive bids was used in the award of many negotiated contracts: the Department would request several manufacturers to submit, more or less informally, their estimated prices. The manufacturer submitting the low price would, other conditions being equal, receive the bulk of the Department's order for the item to be procured. In many cases, the Department

would negotiate contracts with all of the manufacturers submitting prices; the high bidders would receive contracts for lesser quantities than the low bidders. Under this modified form of bidding, however, there was some negotiation in the arrival at the final contract price, and pricing was much more of a problem than it had been under the earlier system of competitive bidding.

iv. Dollar amount of letters of intent

13. The progressive increase in the use of letters of intent indicates the pressure which was being put upon contracting officers. The following table demonstrates the increasing reliance upon letters of intent: [75]

($1,000,000's)

	1941						1942			
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.
al contracts varded	$662.8	342.1	565.6	414.1	487.1	1,026.3	1,372.9	2,927.5	2,202.9	1,953.8
ers of intent	$124.9	20.6	80.1	33.0	23.1	249.6	628.8	2,408.6	1,416.5	860.7
vious months' letrs of intent surseded by conacts executed	.....	.....	.....	.....	$48.2	57.6	26.1	53.7	223.7	297.9

The use of letters of intent in the Bureau of Ships is particularly striking:

Bureau of Ships—Contracts Awarded

($1,000,000's)

	1941, Dec.	1942 Jan.	Feb.	Mar.	Apr.
Total contracts awarded	$119.4	361.7	315.7	628.4	230.8
Letters of intent	$119.4	361.7	313.5	628.4	225.8
Previous months' letters of intent superseded by contracts	$0.3	.....	6.1	.....	.....

14. In conclusion, the contract figures for the fiscal year 1942, from July, 1941 until the passage of the renegotiation statute, show (1) a great increase in the amount of matériel contracted for, (2) virtual abandonment of competitive bidding as a method of awarding contracts and (3) an increasing use of the letter of intent.

b. General Factors Making Close Prices Difficult

15. A number of factors complicated the procurement programs at this time. These factors were more or less inevitable with the outbreak of war and the huge spurt in procurement.

i. Lack of experience

16. The enormous increase in procurement tells its own story. The Navy Department had no experience enabling it to cope with the problem of fixing close [76] prices under the new procurement programs. Contractors were being asked to produce items in quantities never before contemplated. Thus, in late 1940 and early 1941, contracts for vessels were let in quantities exceeding those of the first World War, and in early 1942, these quantities were still again increased. A single contract for one ordinance item (5″ gun mounts) which had theretofore not been made outside Government gun factories, called for a quantity of such items in excess of the total number previously made in this country in the gun factories. Many other examples could be cited.

17. Contractors were called upon to manufacture new items which had never before been produced—such items as radar equipment, new plane and vessel designs, floating drydocks, and Bofors and Oerlikon guns. Specifications for some items were not completed until the con-

tract was performed; the requirements for other items were changed constantly through the life of the contract.

18. Many contracts were long-term contracts which extended for more than one year. The majority in dollar volume of combatant ship contracts were contracts for twelve months or more. Similarly, most of the contracts for construction of public works and facilities, and for air frames and engines were long-term contracts. The bulk in dollar amount of contracts let for these items in the *fiscal* year 1942, prior to passage of the renegotiation statute, ran until 1942 or 1943. Almost all aircraft and construction contracts were let on a cost-plus-a-fixed-fee basis. Of the contracts for vessels, a larger dollar amount were made on the fixed-price basis, but these fixed-price contracts were made subject to adjustment and escalation in respect of direct labor and material costs. [77]

19. Contracts were awarded to many contractors, particularly in the aircraft industry, in amounts tens and even hundreds of times greater than their capital investments.

ii. Problems in building up procurement personnel and organization

20. For the fiscal year 1940, obligations of Navy appropriated funds totalled approximately 1.1 billion dollars; for the fiscal year 1941, obligations were about 12.7 billion dollars, (note the table in paragraph 9 above). In fiscal 1942 total obligations were 23.2 billion dollars, with obligations in the second half of such fiscal year (i.e., the first half of calendar 1942) amounting to 17.2 billion. The dollar volume of obligations incurred in the first six months of 1942 was comparable to the dollar volume of obligations incurred in the preceding two and one-half

years (2.8 billion dollars less). The great jump in contract obligations which took place in the second half of 1940 was largely due to the great expansion in shipbuilding authorized in mid-1940, and, to a somewhat lesser extent, to the expansion in plane authorizations and construction of public works and facilities.

21. Within two years, the procurement machinery of the Navy had to be stepped up to the point where it could turn out, in a six-months' period, contracts for munitions for about thirty-one times the dollar amount of the obligations incurred in the first half of 1940 (approximately $0.55 billion—50% of the $1.1 billion commitments recorded for the twelve months of fiscal 1940—as compared with $17.2 billion in the first six months of 1942). The difficulties of turning out the contracts for the widely diversified items procured by the Navy (from battleships to buttons, from planes to pork products) increased rather in a geometric progression as the dollar amount of Navy needs [78] and the number of Navy contracts necessary to fulfill such needs multiplied.

22. The Navy Department started its emergency procurement program in June, 1940, with personnel adequate to handle one billion dollars of procurement per year; it was impossible, within the year and one-half which followed, to build up the personnel who could handle procurement at the rate of 34 billion dollars per year (17.2 billion dollars for the first half of 1942), and at the same time achieve close pricing on the munitions for which contracts were being written. Even if there were in the country enough persons skilled in procurement problems and analysis of costs to undertake to fix close prices on

munitions, such persons would have had no background of experience in the prices of a large proportion (if not most in dollar volume) of the items procured by the Navy. Not only was the Navy Department purchasing many items which had never before been made by the contractors, but it was also purchasing items in such quantities in 1941 and early 1942 that previous price experience was almost useless as a guide.

23. It is most important to recognize that pricing was only one of the factors which had to be considered by the Navy Department in expanding its procurement. The enormous increase in the number of technical personnel—engineers, architects, designers—required to handle the specifications for Naval matériel can be understood readily enough. Another factor too often overlooked is the mechanical problem of getting out completed contracts. The Bureaus, which prepared all of the contracts, had to set up entirely new contract organizations. The coordination of procurement by the Bureaus became increasingly difficult—what had been relatively simple when procurement was at the rate of one billion dollars a [79] year became extremely complex when procurement jumped twelvefold, and then twenty-three fold. Many different efforts at coordination were made; the agencies most responsible for unifying contract policies—the Procurement Legal Division of the Under Secretary's Office and the Office of Procurement and Material of the Secretary's Office—were not established until July, 1941 and January, 1942, respectively. Organizations to assist contractors—in obtaining priorities, solving labor problems, building facilities, securing capital—all had to be established and manned, and it took time for such organizations to acquire

the necessary know-how. Other organizations were required to coordinate Navy procurement policies and procedures with the policies and procedures of other Government agencies, to prevent the competition for contractors which helped to demoralize the early procurement of World War I.

24. The Navy Department had made a fair beginning towards solving these many problems at the time war was declared. The declaration of war, however, at the same time rendered imperative the immediate functioning of all of the agencies necessary to handle the procurement problems, and also made the problems much more acute. Through all of the process of organization for wartime procurement, the contracts had to be turned out, and in far vaster quantities than theretofore. One partial solution, of course, was the issuance of letters of intent rather than the more formal contracts, which could be worked out thereafter. The figures which I have cited earlier indicate the extent to which this device was used in the period under consideration. The use of letters of intent, however, merely postponed the day when the more formal contract was to be written; and at several times the backlog of letters of intent became peri- [80] lously large. and the problem of pricing still remained when letters of intent were used. The Department did issue some letters of intent under which prices were fixed, but as a general rule, the letters of intent were silent as to prices, with the understanding that prices would be set later in the definitive contract.

25. The Navy Department was struggling, throughout the year and one-half prior to passage of the renegotiation statute, to obtain personnel to get out the specifications,

to write the contracts, and to aid in the production, of the material required. Indeed, we have not today completely solved this problem—we still have need of experienced personnel who can take over the constantly changing procurement problems.

iii. Uncertainties as to costs

26. Added to the absolute lack of experience as to the cost of many items and the difficulties inherent in training personnel to meet new problems of theretofore unrivalled magnitude, were the many uncertainties as to certain costs—in 1941 and 1942 the scarcity of materials and of manpower, and rising prices and wages, made particularly difficult the forecasting of costs.

27. The problem of material shortages became acute in early 1942. The predecessor to the War Production Board had been established to administer the priorities authorized by the "Navy Speed-Up Act" of June 28, 1940. The Army and Navy Munitions Board had been working with the War Production Board and its predecessors for the one and three-quarter years prior to April, 1942, in enforcing a system of priorities in metals for Government contracts. In the first half of 1942 the armed services and the War Production Board were engaged in working out a system of control much stricter than that theretofore in [81] effect—the Production Requirements Plan, which was put into effect on July 1, 1942. The application of all of the priority ratings was an immensely complicated job, which was administered in the Navy Department by the Production Branch of the Office of Procurement and Material. In addition to the metals covered by the priority schedules, there were several other

raw materials which were at this time extremely critical because of shipping losses and other factors.

28. At this same time also, manpower shortages were beginning to be felt as the draft was stepped up enormously, although the shortage in manpower became most critical some months later.

29. The armed services had experienced some labor and wage troubles at the plants of contractors. The most acute cases were, of course, those of North American Aviation, Inc., which was taken over by the War Department under Executive Order No. 8773 dated June 9, 1941, and Federal Shipbuilding & Dry Dock Co., which was taken over by the Navy Department under Executive Order No. 8868, dated August 23, 1941. Wages were rising, from early 1941 onward. In mid-1941, the Navy took the initiative in having the nation's shipbuilders enter into zone agreements with respect to labor. These agreements, while they helped to insure a supply of labor, had the undoubted effect of raising labor costs at most shipyards, including those not covered by the agreements, which tended to raise wages for all shipyard workers. There was also established a shipbuilding stabilization program reimbursement policy, to which the Navy Department, War Department and Maritime Commission adhered; the three agencies have from time to time issued administrative instructions governing reimbursement to shipbuilders of specific labor costs. Zone agreements. Zone agreements somewhat similar to those in the [82] shipbuilding industry were likewise established for the construction and building-trades industries.

30. Wages continued to rise throughout late 1941 and the first part of 1942, and the trend was not effectively

checked until after the President's "hold-the-line" Executive Order 9250 (promulgated upon passage of the Second Emergency Price Control Act of 1942 on October 2, 1942) which empowered the President to establish wage ceilings. Overtime charges began to mount in late 1941. As the War and Navy Departments demanded speeded-up production and extra shifts, they promised fixed-price contractors, who had not contemplated substantial overtime wages at the time their contracts were let, that the contract prices would be adjusted in the light of the overtime payments.

31. Scarcity of materials and growing scarcity of manpower made for higher costs to contractors. From the very inception of the national defense program, contractors were fearful of price rises which might wipe out not only their profits under long-term contracts, but also their entire companies. They were therefore insistent upon protection by the Government against such price rises. From the latter part of 1940 on, escalator clauses were demanded with increasing frequency under fixed-price contracts. In 1941 and early 1942. I should judge that the great majority in dollar amount of fixed-price contracts provided escalation in some form or another. Many contractors faced with the production uncertainties which I have outlined above, in addition to price increases, insisted upon cost-plus-a-fixed-fee contracts to protect themselves.

32. Increases in production and in efficiency were so swift that in many cases the increased costs which had been anticipated and were to be covered by escalation [83] were completely swallowed up in the greater than anticipated profits earned by contractors. It had been,

and still is, generally impossible to forecast accurately the effects upon costs, of increased volume or of the productive efficiency of Navy contractors. In addition to this fact that contingent costs (against which escalation was provided) were offset by unanticipated profits, the fixed price under any contract containing an escalator clause invariably also contained allowances for many contingencies not covered by escalation. Escalator clauses did not provide complete protection against fluctuation in costs; there were at the time many uncertainties as to overhead costs against which the contractor claimed to have no protection except amounts for contingencies included in his contract price. In practice, price escalation worked only upwards, although the escalator clause generally did provide for revision downwards of prices based on direct labor and material costs, as well as for revision upwards thereof. The cost-plus-a-fixed-fee contract was virtually a riskless contract. As the production of so many contractors increased many times over, the return in profits under fees fixed upon the volume of their business amounted to vastly more on their capitalization than had profits prior to the emergency and war periods.

33. Manufacturers demanded protection against the uncertainties facing them; the Navy Department, which had no means of forecasting costs, of necessity had to provide the protection in its contracts in order to obtain the munitions. In general, Navy contractors in 1941 and early 1942 were including in their fixed-price or estimated cost (under cost-plus-a-fixed-fee contracts) allowances for almost all contingencies which could conceivably happen. Almost never did more than a portion of such contingencies happen with respect to a single contractor. In addi-

tion, pro- [84] duction techniques improved so much more rapidly than expected with respect to a great many items that actual costs in quantity procurement were far lower than those which might reasonably have been expected.

iv. Navy contracting and pricing personnel

34. As the statistics earlier cited make clear, most of the increased procurement from mid-1940 to April 1942 (and to date) has been accomplished under negotiated contracts. A very substantial proportion of these contracts were cost-plus-a-fixed-fee contracts, including almost all construction contracts and plane contracts; all facilities contracts provided for reimbursement of costs to the contractor. With respect to the fixed-price negotiated contracts, it was necessary to negotiate prices with the contractors on the basis of estimated costs. The cost of performance was to the extent possible based upon past experience, but past costs were generally stepped up by the inclusion of allowances covering the many uncertainties facing the contractor. The contractor would not undertake the work without adequate protection—and the Navy Department had no valid argument, in the light of the uncertainties as to costs facing the contractor, for rejecting allowances for the protection of the contractor. There was always the possibility, of course, that not all of the contingencies against which protection was being provided in the price would occur, but no one in the Navy Department or anywhere else was able to forecast what contingencies would occur and what ones would not. It is true that many of the fixed-price contracts provided escalation for certain costs, but the inclusion of escalation was necessary in such cases to provide the further cushion

without which the contractor would not undertake to risk the hazards inherent in a fixed price. [85]

35. Prices under contracts awarded after competitive bids were of little aid in determining prices for similar items under negotiated fixed-price contracts. Bidders for Navy contracts submitted bids on the basis of comparative prices and of what they anticipated would be the lowest price, rather than on any very close analysis of costs. In any event, the quantities specified in these earlier contracts and the conditions under which they were let did not afford any precedent for pricing in the later period. With the advent of the negotiated contract, more and more of the nation's industrial capacity was converted to Government work. Competitive forces ceased to have any bearing upon prices—in practical effect, all contracts let were based upon crude estimates of costs, however faulty the early estimates might be, plus an additum for contingencies and profit. As the House Naval Affairs Committee discovered, prices under negotiated contracts were generally lower than prices for comparable items under contracts let to the lowest bidder.

36. At the beginning of the emergency period (June, 1940), the outlook of the Bureaus relative to prices was slanted almost entirely towards purchasing on the competitive bid basis. The Bureau of Supplies and Accounts continued to award some contracts during this period of early 1942 on the basis of competitive bids. Several of the Bureaus had personnel who dealt with comparative prices, based on past experience; such personnel sought to work out prices with contractors. The Bureau of Supplies and Accounts, which had been purchasing standard items in quantity for years, did have some comparative data on

prices, based on the competitive bid awards. But, as procurement vaulted to quantities many more times the quantities purchased before the war, this data became increasingly obsolete. [86] It was true that the Stock, Schedule and Statistical Sections of the Bureau kept records of past purchases and that such records would be of value in ascertaining the propriety of a negotiated fixed-price. The other Bureaus had only a handful of personnel engaged in drafting of contracts and pricing thereunder, and began in the latter part of 1940 to build up their contract divisions.

37. The new contracting personnel necessary to handle the increased volume of procurement, gradually gained experience with pricing; their training took time. At the start of the emergency procurement, there was on hand inadequate data as to contractors' costs, and consideration of prices offered by contractors was based largely on comparison with prices paid by the Navy for similar munitions in the past, usually under very different conditions. Past experience naturally offered little guide in the determination of prices to be paid for articles which had never been built before, as we discovered in the cases of destroyer-escorts and anti-aircraft guns, for example.

38. As of April 28, 1942 the Navy Department did not have any working organization whose primary responsibilities were analysis of prices and advice in the negotiation of accurate prices which when compared with costs would not allow undue profits. The Cost Analysis Section and the Price Adjustment Board had just been established in the Office of Procurement and Material (itself organized on January 30, 1942) attached to the Secretary's Office, and had had little opportunity to ac-

complish anything in the way of recommending price reductions. There was no agency—and would not be until July or August, 1942, when the Price Negotiation Branch of Supplies and Accounts was set up—which was in negotiating a [87] procurement deal solely responsible for checking into the contractor's probable costs and for seeking to determine whether the prices submitted should be reduced. A lot of thought had gone into the matter of high prices and excessive profits, and we were slowly moving toward corrective measures which proved to be effective. It is true that before the war, almost half in dollar amount of negotiated contracts were let on a cost-plus-a-fixed-fee basis, or on a cost basis in the case of facilities, and a substantial portion of contracts were still being made to the lowest bidder after solicitation of competitive bids. Past experience was of little assistance in the latter case. Most of the large profits earned by Navy contractors were due to increased volume or ability of the contractor, making a new article with which he was unfamiliar, to reduce his costs promptly, and to allowances for contingencies which did not arise. The Navy Department did not have the pricing experience at this time to deal adequately with these factors. Again I want to point out quite frankly that the Department was primarily interested in getting the munitions as promptly as possible. In the haste to acquire the matériel of war, it had also to expand and develop its procurement organization. The Navy Department had at the time neither the knowledge nor the experienced personnel necessary to achieve close pricing—and indeed, during wartime, it may be doubted whether anything but limited success in negotiating prices to reflect costs be achieved.

c. Specific Contract Prices During This Period (July, 1941-April, 1942)

39. Naturally, as contractors gained experience, and as the Navy became better able to analyze costs, it has [88] been possible to negotiate lower prices on a great many items. I have listed some of the factors which made for high prices and high profits. I submit some actual examples of prices uder contracts let during this period and subsequent reductions of these prices.

i. Bureau of Ships

40. The Bureau of Ships was responsible in 1941 and 1942 for the expenditure of a larger dollar volume of appropriations than was any other Bureau (although the Bureau of Supplies and Accounts in the months prior to passage of the renegotiation statute was writing a larger dollar volume of contracts, because of the large number of contracts such Bureau wrote upon requisition from the other Bureaus). The value of ships completed and converted under Navy contracts rose from about $142,146,000 in the second half of 1940, to $720,494,000 in the first half of 1942, to $3,590,509,000 in the first half of 1944. For the fiscal year 1941 (July 1, 1940-June 30, 1941), *expenditures* by the Bureau of Ships totaled $912,000,000, as compared with $3,074,000,000 for the next fiscal year, and $9,384,000,000 for the fiscal year 1944 (June, 1944, estimated).

41. The contracts necessary to fulfill the 11% and 70% expansions of the Navy (authorized by the Congress in June and July, 1940) were largely awarded by the end of the first quarter of 1941. In general, these contracts, which each specified the delivery of a number of combatant

ships, were not completed until the latter part of 1942 and 1943. On the average, the following lengths of time are required to complete the several combatant ships:

Battleships	32 to 35 months.
Aircraft carriers	17 to 21 months. (The escort carriers require about 11 months.

[89]

Cruisers	22 to 25 months.
Destroyers	7 to 13 months.
Destroyer Escorts	7 months.
Submarines	11 months.

42. I have had compiled data on some 13 contracts executed between July 1940 and February, 1941, covering combatant ships. These contracts, all of which were made on a fixed-price basis, subject to adjustment according to changes in direct labor and material costs, provided a total of $750,097,400 (before adjustment) of contract prices. None of these contracts was completed until late 1942 or 1943. They were completed at a total cost to the contractors of $514,720,566. The total profit under the contracts, disregarding adjustments and disregarding renegotiation and voluntary refunds, would therefore have amounted to $235,376,834, or 45.7% of the cost of performance. The cost of performance included increases in labor and material prices during the lives of the contracts, whereas the contract prices as above stated have not been adjusted upward in accordance with escalator adjustments to which the contractors would have been entitled under their contracts. Since the basic month for escalator purposes was between July, 1940 and February, 1941, and the expenditures were incurred from one to two years later, sharp upward adjustments would have been required if escala-

tion had been computed—it is estimated that such adjustments would have amounted to 10 to 15% of the cost in the case of destroyers, and 15 to 20% of the cost in the case of the larger vessels. As examples of the discrepancies between original unit contract prices and unit costs to the contractor under these contracts, I cite the following: [90]

	Number of Ships	Original Unit Price	Average Unit Cost	Difference as Percentage of Costs
			Destroyer Program	
1st contract	6	$7,159,700	$5,445,225	31.5
2nd contract	6	6,813,200	4,560,074	49.5
3rd contract	8	5,379,000	4,705,896	14.3
4th contract	5	7,360,000	4,900,245	50.2
5th contract	17	6,813,000	4,425,605	53.9
6th contract	6	5,977,000	4,241,268	40.9
7th contract	4	5,579,000	4,620,142	20.8
			Carrier Program	
1st contract	2	43,662,000	26,625,000	64.0
2nd contract	1	42,725,000	26,500,000	70.6
3rd contract	3	46,125,000	26,600,000	73.4
			Cruiser Program	
	2	19,272,500	14,725,000	30.9
			Submarine Program	
1st contract	13	2,795,000	2,246,761	24.4
2nd contract	25	2,765,000	2,246,761	23.1

At the time of the award of the above contracts, there was an informal understanding between the Bureau of Ships and the contractors that if actual costs proved to be out of line with the prices fixed, some adjustments would be made. In practice, since none of these contracts was completed until after the passage of the renegotiation statute, all were renegotiated under the statute.

43. Both the destroyer-escort program and the landing-craft program were launched in force in early 1942, although the great majority of contracts for these vessels were not executed until after passage of the renegotiation statute. In neither case had the contractors or the Navy Department had any experience [91] with building these new types of vessels, and original costs were naturally high, because specifications were constantly changing on the early vessels. No contracts for destroyer-escorts were made prior to passage of the renegotiation statute. Work had been begun, however, on several of the vessels, and general agreement on an estimated cost of $3,300,000 per vessel was reached in the first part of 1942. All of the contracts for these ships except one was made on a cost-plus-a-fixed-fee basis, and the resulting actual costs of the ships indicate the difficulty of arriving at a fair estimate for an item which has never been made before. Actual costs under eight contracts varied from $1,440,198 per vessel to $2,667,583 per vessel (the next highest being $2,348,578). The total fees fixed on the eight contracts amounted to 11.87% of the actual cost. Under the single fixed-price contract, which provided a unit price of $3,-500,000, actual unit costs amounted to $1,809,644, or a profit without renegotiation of 93.4%. As I have earlier indicated, the contractor who took work on a fixed-price basis was entitled to cushions for the many contingencies which might arise and wipe out his profits. There was a definite agreement with respect to the destroyer-escort contracts that as costs were more accurately determined, prices and estimated costs would be adjusted accordingly. The Navy Department was in no position to insist upon the elimination of cushions from the price of a ship which

had never before been built, with all of the uncertainties as to costs facing the contractor.

44. With respect to propulsion machinery, I shall repeat an example which was submitted by Secretary Knox to the Congress in April, 1942.[1] Secretary Knox said: [92]

> For example, one of our suppliers with whom we had a contract for 200 destroyer turbines produced the first turbine on our designs at a cost of $2,559,000, which was very substantially above what that company's engineers had estimated the cost would be. After the production of 15 turbines, through economies of operation and increased efficiency, this cost was reduced to $607,000 per turbine. It is now estimated by the company that it will not be until after completion of the seventy-second turbine that the cost will drop to the figure estimated in quoting to the Navy the contract price of $300,000 per turbine. This latter cost the company believes will be stable.

ii. Bureau of Ordnance

45. During this period in question, a very large amount of ordnance items were procured under contracts made by the Bureau of Supplies and Accounts. *Expenditures* by the Bureau of Ordnance increased from $377,000,000 for the fiscal year 1941, to $1,915,000,000 for the next fiscal year and $3,634,000,000 for the fiscal year 1944.

46. Typical of the increases in volume of ordnance procurement is the jump in production under Navy con-

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[1]Hearings before the House Naval Affairs Committee on H. R. 6790, 77th Cong., 2d Sess., April 16, 1942, page 2922.

tracts of one antiaircraft gun from approximately 1,000 in the last half of 1941 to about 10,500 in the first half of 1942; another gun jumped from 300 to 1,000 over the same two periods (top production of this item was reached in the second half of 1943 with 3,800 production). Production of Navy ammunition multiplied many times over in 1942.

47. The progressive reductions in prices of two types of antiaircraft guns which had not prior to the present emergency been manufactured in this country is most striking. These guns have been manufactured [93] for the most part by former automobile manufacturers, who had previously had no prior experience in their production. The Oerlikon gun (20 mm.) with one type of mount was manufactured under one contract made September 9, 1941 for a price of $7,531.42 per gun; under a contract dated January 20, 1943 with another manufacturer, its price had been reduced to $4,519.97, with a still different type of mount, a contract for the Oerlikon guns dated September 22, 1942 specified a unit price of $6,330; the later contract with the same manufacturer dated May 5, 1944 had brought the price down to $3,666. This same type of gun was made without mounts under a contract dated June 8, 1942, fixing a unit price of $4,958.50; the present contract with the same manufacturer dated May 5, 1944 specifies unit prices ranging from $2,133 down to $1,708 as production increases.

48. The Bofors gun (40 mm.) prices show equally astonishing decreases. The original contract dated January 7, 1942 specified a unit price of $4,288 (without mounts); the later contract with this manufacturer dated November 11, 1943 brought the price down to $2,510.

49. Prices of 20 mm. and 40 mm. projectiles have come down to about 50% of the original prices. These items are items as to which the changes in specifications have not presented the problem present with respect to many naval munitions. Quantities produced under Navy contracts have multiplied many times over during the past three years, and the price reductions may be attributed in large part to increases in volume. Production of the 20 mm. shells was begun in June, 1941 under eight contracts specifying unit prices which varied between 21.5¢ and 25.23¢ per shell; the most recent contracts in January and May of 1944 specify prices from 11.2¢ to 14.46¢ per shell. Simi- [94] larly, production of 40 mm. pro-jectiles began in June and July, 1941 under eight contracts with prices ranging from 64¢ to 84¢ per unit; the latest contracts, executed in August and November, 1943 and September, 1944, provide payment of between 43¢ and 50¢ per shell.

50. Prices of other ordnance items have indicated how difficult it is to arrive at a price under the original contracts. One model of gunsight has dropped from $2,638.29 to $1,571.19. A case for depth charges which originally cost the Government $15.07 was later reduced to $10.31. Three-inch gun-barrel forgings were priced at $1,580 under the original contract of May 5, 1941; under the contract dated November 21, 1942, the price had gone down to $1,000.

iii. Bureau of Supplies and Accounts

51. This Bureau purchases all of the standard supplies, hardware, clothing, subsistence items, and the like. The Bureau both prepares the specifications and writes

the contracts for most standard supply items—hand tools, repair materials, furniture, stock items and the like. In 1941 and 1942 the Bureau of Supplies and Accounts also wrote a great many contracts for the other Bureaus, which drew up the specifications for the items to be procured, negotiated the price, and then sent a "requisition" covering the procurement to the Bureau of Supplies and Accounts to be written up in contract form.

52. Total *expenditures* of the Bureau (for items as to which it both prepared the specifications and wrote the contracts) increased from $563,000,000 in fiscal 1941 to $1,409,000,000 in fiscal 1942 and to $6,127,000,000 in fiscal 1944. These figures include expenditure of very substantial amounts for pay, subsistence and transportation of naval personnel. A very large [95] proportion in dollar amount of the Bureau's total procurement consists of petroleum products.

53. The prices under Navy contracts of most of the subsistence items and clothing items are so closely related to material costs that volume procurement does not have any appreciable effect upon the prices. I do not therefore present any examples of purchases of either subsistence or clothing items.

54. I shall cite several examples of reductions in the prices of some standard stock items largely as a result of purchasing in large quantities. Thus, twist drills are purchased under contracts for hundreds of thousands of dollars; the unit prices for these drills in different sizes and specifications vary from 8 or 10¢ to several dollars. Prices under a 1944 contract with one manufacturer for assorted lots of drills were 22½% less than prices under a 1942 contract with the same manufacturer. Another

item of hand tools—hand taps—are purchased in a very wide variety of sizes and prices. Prices under a 1944 contract for hand taps show a decrease of 20% under the prices specified in a 1942 contract with the same manufacturer.

55. Comparison of prices for sisal rope of a certain specification under two contracts with the same manufacturer shows the following unit prices:

Size of rope	Price per pound	
	1942 contract	1944 contract
¾″	$0.195	$0.1835
1⅛″	.19	.1763
1½″	.1825	.1619
4½″	.175	.1547
8″	.175	.1547

The differences per pound are in cents and fractions of cents; but as the contracts involve several [96] hundreds of thousands of pounds of rope, these differences become quite large in total.

56. The difference is even more substantial in the case of steel cable. One of the early contracts, made in 1941, specified a price for certain ⅛″ steel tow cable of $0.051 per foot; the contract for the same type of cable with the same manufacturer in 1944 provided a price of $0.037 per foot—a decrease of $0.014 per foot, or 28%. The later contract required delivery of 30,000,000 feet of cable, so that the total decrease from the original price amounted to $580,000.

57. Paint brushes under two contracts about 10 months apart (both executed in 1944) with the same manu-

facturer decreased from $2.95 to $2.61 for one size, from $2.67 to $2.34 for another; again, the difference is substantial under a contract for 105,578 brushes.

58. Perhaps a comparison of prices of nuts and bolts under a 1943 contract and a 1944 contract will bring home as cogently as any other comparison the difficulty of close pricing on small standard items. Under the earlier contract, the price for one ½″ by 5″ bolt and nut was $2.86 per hundred, while the price under the later contract was $2.12 per hundred; the prices for a ¾″ by 6″ bolt and nut were $7.51 per hundred as compared with $5.30 per hundred. Even more striking is the difference between the prices for a 1″ by 5″ bolt and nut—$14.90 per hundred under the first contract, and $10.10 under the second.

iv. Bureau of Aeronautics

59. All contracts for aircraft and aircraft components during 1941 and 1942 were drafted and executed by the Bureau of Supplies and Accounts, although prices and terms under these contracts were negotiated by the Bureau of Aeronautics. *Expenditure* of appro- [97] priations for which the Bureau of Aeronautics was responsible increased from $194,000,000 in fiscal 1941 to $1,052,000,000 in the next fiscal year, and $4,696,000,000 in fiscal 1944. Total aircraft accepted (reflecting earlier contracts made) increased 122% from the first half of 1941 to the second half of 1941; acceptances in the first half of 1942 were 210% of acceptances in the preceding six months; and the second half of 1942 saw acceptances more than 200% of those for the first half of that year.

60. The contracts for airframes during this period were, with one exception, all cost-plus-a-fixed-fee contracts. They were invariably long-term contracts, in general extending over 18 months or more. The airframe manufacturers required cost-plus-a-fixed-fee contracts at this time, for their margin of capital in relation to total business was so small that they could not afford to incur any risks. For example, the Grumman Company had a capital of $5,000,000, yet its contracts with the Navy approximated half a billion dollars.

61. In the contracts for both airframes and engines, innumerable changes in specifications are made during the life of the contract.

62. One cost-plus-a-fixed-fee contract for torpedo bomber frames was let on March 23, 1942, at an estimated unit cost (plus fee) per plane of $101,863. This same contract was later converted into a fixed-price contract providing for incentive payments as reductions were made below specified costs, and as of September 30, 1944, the unit redetermined price was $58,050. A cost-plus-a-fixed-fee contract for scout bomber frames was made on February 2, 1942, at an estimated unit cost (plus fee) of $34,019 per plane; the present contract for the same frames is on the basis of $30,160 estimated unit cost. Finally, a con- [98] tract made May 23, 1942, on a cost-plus-a-fixed-fee basis provides an estimated unit cost of $63,985 for fighter frames; the most recent contract for these frames (fixed-price adjusted contract) calls for a unit price of $39,000.

63. Similar decreases are evident in the procurement of engines and propellers. Prices under 1941 and 1942 contracts for three different types of engines and two types

of propellers, and prices under more recent contracts for the same articles may be compared as follows:

	Old Contract			Latest Contract		
	Date	No.	Unit Price	Date	No.	Unit Price
1st Type Engine	9/10/41	204	$14,500	12/29/43	439	$11,200
2nd Type Engine	7/29/41	2,293	13,151	12/29/43	400	11,051
3rd Type Engine	7/14/41	80	6,522	12/29/43	1,400	5,848
1st Type Propeller	4/ 4/42	259	1,081	12/23/43	583	878
2nd Type Propeller	3/30/42	248	2,266	12/29/43	3,375	1,880

64. The procurement of aircraft components likewise shows striking reductions in contract prices as the items are produced in greater quantities and as mechanical problems are surmounted. The following table shows the reductions in prices which have been effected for some items:

	Old Contract		Latest Contract	
	Date	Unit Price	Date	Unit Price
Motor Alternator	4/27/42	$280.00	5/15/44	$173.00
Starter—1st type	3/ 1/42	370.00	3/ 4/43	333.00
Starter—2nd type	2/ 2/42	355.00	12/ 2/43	290.00
Generator	9/11/41	343.00	7/11/44	229.00
Navigational Watch	5/28/41	30.25	3/23/44	28.45
Oil Pressure Gauge	10/16/41	2.35	11/10/43	1.95
Compass	8/22/40	43.50	4/13/44	35.72

v. Bureau of Yards and Docks

65. The expenditures of the Bureau of Yards and Docks increased from $412,000,000 in the fiscal year [99] 1941 to $1,076,000,000 in the fiscal year 1942, and $2,265,000,000 in fiscal 1943. The Bureau's work reached its peak in the second half of 1942, when some $1,768,625,000 of work was reported completed on projects under

the supervision of the Bureau of Yards and Docks. The great bulk of this work was done under contracts which had been made prior to passage of the renegotiation statute—indeed, many of them were made in 1939, 1940 and 1941, when some of the large contracts for base projects and advance bases had been let. The Bureau of Yards and Docks supervises construction of industrial facilities under the facilities contracts made by the other Bureaus.

66. The peak in the making of construction contracts and the peak of construction thereunder was reached in 1942. Commitments for all types of facilities (industrial and non-industrial) for the first half of 1942 totaled $2,742,100,000, for the second half of 1942, $1,420,400,000; expenditures for work completed in these two six-months' periods were $1,275,000,000 and $2,190,000,000, respectively. The bulk of facilities contracts executed in the last six months of 1941 and the first four months of 1942 extended beyond the date of passage of the renegotiation statute on April 28, 1942.

67. It has been estimated that roughly 80% in dollar volume of construction contracts and extensions thereof made by the Bureau of Yards and Docks in fiscal 1942 required over 8 months to perform. Most of the very large construction contracts for construction of new bases extend over more than 12 months. It is of course impossible to compare costs or prices of different construction jobs, although prices of construction materials may be compared.

68. As to items procured by the Bureau of Yards and Docks, I shall cite as examples two items—pon- [100] toons and floating dry docks. The pontoon program was started near the end of 1941 with an order for a few

thousand pontoons; the number contracted for multiplied over six times in 1942, and increased in 1943 far beyond what anyone had anticipated. The Bureau procures two major types of pontoons, one of which is procured in numbers about 9 times as large as the other type. Prices have come down as follows:

	1st type	2nd type (procured in the larger quantities)
1941 (includes development costs)	$400	$660
1942	335	370
Late 1942	.....	250
1944	270	200

Construction of floating dry docks began in 1941. These were an entirely new item, and extensive changes in specifications and designs were made during the life of the early contracts. All of these contracts extended beyond April 28, 1942.

II. ACTION BY THE NAVY DEPARTMENT WITH RESPECT TO EXCESSIVE PROFITS

69. The Navy Department in 1941 and the early part of 1942 had only begun to build up machinery for the purpose of ascertaining and recapturing excessive profits under its contracts. I have pointed out the enormous increase in the number of contracts and in the volume of Navy procurement during this period, and the impossibility of acquiring experienced personnel forthwith, to negotiate the best possible prices for the Government. During the period in question [101] (the latter part of 1941 and the first four months of 1942), the Navy Department

discovered that some of its contractors were earning very large profits. We endeavored to correct the situations which came to our attention. It proved impossible then to achieve close initial pricing under most Navy contracts. After our experience of the last several years I am convinced that it will always be impossible in wartime to arrive at close prices for munitions, when the Government is uncertain as to the types of quantities of munitions which are needed (and the exigencies of war are such that we are almost never certain as to types and quantities).

a. 1941 Investigations

70. In the first half of 1941, both the House Naval Affairs Investigating Committee and the Truman Committee sent out questionnaires relative to profits to manufacturers and shipbuilders holding Navy contracts. The Truman Committee in June 1941, conducted hearings upon costs and profits under ship contracts and contracts for ship repair and alteration. These investigations brought out the fact that very large profits were being enjoyed by some contractors; the Truman Committee was particularly concerned with profits under ship repair and alteration contracts. Before these Committees had published any reports, however, the Navy Department made efforts to correct some of the contract prices, particularly under the ship-repair contracts. The first step was to make sure that the Bureau of Internal Revenue would treat a voluntary refund by a contractor as a reduction in his contract price and in his taxable income; in response to inquiries by the Navy Department, the Treasury Department in September 1941 indicated that for tax purposes

it would so regard such a refund, provided the original contract was modified in writing to indicate [102] the reduced price. Thereafter the Treasury further indicated that a refund made after completion of performance of the contract would likewise be regarded for tax purposes as a reduction of gross income.

71. Mr. Forrestal (then Under Secretary) and Rear Admiral Samuel M. Robinson (then Chief of the Bureau of Ships) in September of 1941 requested the Compensation Board to investigate the cost records of contractors who were to complete ships under Navy contracts in 1941 and the first six months of 1942, and to determine what the prabable profits in the construction of those ships would be. The Compensation Board was an administrative agency which had been set up by the Secretary of the Navy in the first World War to review costs under cost-plus contracts, and to advise the Secretary generally on amounts claimed by contractors under Navy contracts. Its functions in reviewing costs under contracts had been taken over largely in late 1941 by the Cost Inspection Service of the Bureau of Supplies and Accounts (the Cost Inspection Service was given complete responsibility to inspect costs under cost-plus-a-fixed-fee contracts, except those made by the Bureau of Yards and Docks, by a directive of the Secretary dated February 9, 1942). The Compensation Board planned to have its accounting branch, the Cost Inspection Board, go over the cost records of contractors under outstanding vessel contracts and attempt to estimate what the profits would be under such contracts. It was anticipated that in cases where the profits appeared to be excessive, the Bureau of Ships, acting in conjunction with the Compensation Board, would en-

deavor to persuade the contractors voluntarily to reduce prices. The Bureau of Ships had estimated that by limiting the investigation to contracts for vessels to be de- [103] livered prior to July 1, 1942, performance would be close enough to completion so that a fairly accurate estimate of anticipated profits could be made. Both the Compensation Board and contracting representatives of the Bureau of Ships felt that it would be wise to persuade contractors in advance to modify their contracts to allow readjustment in prices to eliminate excessive profits, if possible—a forerunner of the renegotiation clause.

72. The Compensation Board was unable to carry this project to completion. It did begin investigation of costs under the ship contracts, but the outbreak of war and the transfer of the bulk of its cost inspection activities to the Bureau of Supplies and Accounts cut short the study of excessive profits of naval shipbuilders. The Bureau of Ships, aided by the Cost Inspection Division of the Bureau of Supplies and Accounts, late in 1941 began to carry forward certain of the work projected by the Compensation Board, in that it commenced negotiations with a number of shipyards under the ship repair and alteration contracts for revision of the contract billing rates.

73. At this same time, the House Naval Affairs Committee, acting as a Special Committee to investigate the national defense program, pursuant to House Resolution 162, approved April 2, 1941, was undertaking its study of excessive profits under Navy contracts. The Naval Affairs Committee had in April, May and June, 1941, obtained a list of all contractors with the Navy Department, and it sent out to these contractors a general questionnaire, which required the submission of extensive and

explicit information on costs of performance of Navy contracts and profits thereunder. As responses were received from the contractors, supplemental questionnaires drawn to [104] elicit information as to a particular industry, were issued to contractors in different industries. The Committee stated that it had in the second and third quarters of 1941 sent questionnaires to 6,899 contractors holding 16,463 contracts. The questionnaires, which required a considerable amount of effort to fill out, aroused a good deal of protest, and also increased interest in excessive profits on the part of both the contractors and the Navy Department. (These questionnaires and the responses thereto are summarized in the Committee's report issued January 22, 1942, H. Rept. No. 1634, 77th Cong., 2d Sess.)

74. By October of 1941 Representative Vinson, Chairman of the House Naval Affairs Committee, felt that the Committee had acquired sufficient data on profits of Navy contractors to indicate the need for corrective legislation. While he indicated to the Navy Department that the questionnaires returned to the Committee showed that most of its contractors were realizing only a fair profit. he stated further that profits under certain contracts represented an "unconscionable percentage" of the contract price. Therefore, on October 7, 1941, he introduced H. R. 5787 (87 Cong. Rec. 7713) to provide for the recapture of all profits under Government contracts in excess of 7% of the cost of performance thereof. At about this same time, another bill (H. R. 5739) was introduced imposing a flat percentage limitation of profits under war contracts

—in this bill 8% of the contract cost. The Navy Department was opposed at this time and later to the revival of any percentage limitation of profits, such as that contained in the Vinson-Trammell Act. It has had the experience under the Vinson-Trammell Act with such a type of profit limitation, and the officials responsible for procurement in the Department were confident that any reen- [105] actment of such a limitation would impede the procurement programs.

75. Some consideration was given within the Department in the last several months of 1941 to the best method of limiting profits by administrative action. The only concrete results of this consideration were the readjustments effected by the Bureau of Ships in payments under the ship repair and alteration contracts. These contracts were in effect requirement contracts—i.e., the contractor agreed to perform, for compensation based upon reimbursement of cost of materials and a fixed price per man-hour of work, all orders for ship repair or alteration work which might be placed with him by the Navy Department. Around the 1st of December 1941, the Bureau of Ships began to seek voluntary reductions in rates from the shipyards. Between December 1, 1941, and April 1, 1942, the Bureau in effect renegotiated 27 ship repair and alteration contracts, representing a very substantial portion of the outstanding number of such contracts. At hearings before the Senate Naval Affairs Committee on profit limitations late in January and early in February of 1942, Captain Claud A. Jones (Assistant Chief of the Bureau of Ships) indicated that the Navy had recovered about $2,000,000 in profits by renegotiation of the ship repair

and alteration contracts.[2] This figure does not, of course, indicate the savings which would accrue in the future by reason of the renegotiation of such contracts.

76. The work of renegotiating the prices under these contracts was spurred by publication on January 15, 1942, of the Truman Committee's report, which covered among other things profits under Navy contracts for shipbuilding and ship repair and alteration. On [106] January 22, 1942, the House Naval Affairs Investigating Committee issued its first report on the defense program, which dealt extensively (409 pages including appendices) with the matter of profits under Navy contracts.[3] While the Committee noted that average profits under the contracts let by the several Navy Bureaus were not too much out of line, it did indicate some examples of extremely high profits. These profits were unduly high despite the excess profits tax. The whole report dealt with profits in terms of percentages of the contract price. It pointed out that the percentage of profits on sales was greater under uncompleted contracts than under completed contracts, and "that as the defense program progresses, the profits to the contractors are increasing and will tend to increase unless steps are taken to halt the trend." Much emphasis was placed upon this report by the Navy officers responsible for procurement. It also received very wide publicity at the time, the newspapers were full of editorials about the prevention of war profiteering, and the procurement officials of the Navy Department spent a considerable amount of time over the next several months in seeking to devise

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[2]Hearings before the Senate Naval Affairs Committee on H. R. 6355. S. 2027, 77th Cong., 2nd Sess., Page 7.

[3]House Report 1634, 77th Cong., 2nd Sess.

some more effective means of administratively limiting profits under Navy contracts.

b. Study and Suggested Solutions within the Navy Department, February-April, 1942

77. From the end of January, 1942 on, the efforts of Navy procurement officials to find some solution to the problem of policing of costs and profits were redoubled. While no formal organization had been set up to deal with the matter, several groups were devoting most of their time to an investigation of ways and [107] means for limiting profits. The procurement personnel of the several Bureaus worked closely with the investigating personnel of the House Naval Affairs Committee, and were instrumental in suggesting to the committee most of the contractors whose profits were so large as to merit further investigation. The Department was during this same period attempting to work out a sound organization to handle the entire procurement problem, let alone the matter of war profits. It was on January 30, 1942, that the efforts towards coordinating the divergent procurement activities of the several Bureaus culminated in the establishment of the Office of Procurement and Material in the Secretary's Office.

78. At the Under Secretary's request I devoted a large part of my efforts during the months of February, March, and April, 1942 to working out some means of curbing profits under our contracts which would not interfere with the more important objective of obtaining the munitions and supplies required by the Fleet. I spent a great deal of time during this period in discussing this problem with representatives of the Procurement Branch in the newly

formed Office of Procurement and Material, the contracting branches of the several Bureaus, and the accounting personnel in the Bureau of Supplies and Accounts. During these three months the Under Secretary also brought into the Department several men with wide business experience who looked into the entire matter of profits under Navy contracts and who subsequently became members of the Price Adjustment Board (established several weeks prior to passage of the renegotiation statute). The problem of the right way (if there were any "right" way) of handling the problem was, however, still very much in the formative stages—it was not then possible to set up any [108] more definite organization to handle the matter of closer pricing and excessive profits. In February we held several discussions with representatives of the Army procurement services as to the best cure for excessive profits, and considered a proposal to include in war contracts clauses under which the contractor agreed to consider adjustment or renegotiation of the contract prices.

79. Early in March, I submitted to the Under Secretary, on behalf of the Navy group which had been studying the problem, some tentative conclusions. It was the consensus, first, that the Navy Department must continue to rely upon the "profit motive" as an important factor in inducing war production, but that nonetheless, executive profits had a bad effect on public and military morale and also tended to encourage demands for wage increases and decreases in labor efficiency. With respect to the proposal to limit profits to a flat percentage of the cost of performance of contracts, it appeared probable that industry would insist upon a floor under losses if it were to be subjected

to a ceiling upon profits. This floor under losses could be accomplished only under a cost-plus type of contract, which was expensive to supervise and audit, tended to reduce efficiency, and often permitted very high profits on a yearly basis; and the 7% limitation on the fee allowed under such contracts, while low for some businesses, permitted very high returns for other businesses. The amount of manpower and effort required to audit such contracts or to administer the flat percentage type of limitation under fixed-price contracts would be enormous and probably could not be drafted if this limitation were put into effect. With respect to excess profits, it was our position that corporations must be permitted to retain some portion of their profits in order to pre- [109] serve the influence of the profit motive and in such event the amount of profits before taxes in view of the extraordinary ballooning in some industries was often so large as to leave excessive profits even after taxes. There was no easy answer to the problem of effective profit control. It was my view at that time that we should attempt to do as much as we could by starting at the very beginning —in the negotiation of contract prices. The Government should be represented in such negotiations by experienced and skillful negotiators who would endeavor to see that the maximum of effort was produced at the right price. We realized then that in the light of all the imponderables, even skilled negotiators would be unable to achieve close pricing in many instances. It was recommended to the Under Secretary that experienced price negotiators be placed in each of the contracting Bureaus. This suggestion was discussed at considerable length in various meetings and bore fruit several months later in the es-

tablishment of a Price Negotiation Section in the Bureau of Supplies and Accounts, which was ultimately extended to all of the Bureaus of the Navy Department.

80. At about this same time (early March, 1942) as a result of our several discussions within the Department, consideration was given to a proposed directive to be signed by the Secretary with respect to the allowance of reasonable profits on fixed-price negotiated contracts. It was proposed that prices be fixed to allow a profit of 6% generally, but up to 10%, of the estimated cost of the contract, to be determined on the basis of cost data and financial statements submitted by the contractor—in short, an embodiment in each contract of the Vinson-Trammell type of limitation, applied in advance. The directive was discussed in considerable detail on March 13, 1942, by representa- [110] tives of the several Bureaus, the Special Assistant to the Under Secretary, Vice Admiral Robinson (Chief of the Office of Procurement and Material), and myself. We were agreed at this meeting that the proposed directive would tie the Navy Department completely to the percentage limitation of profits concept, with all of its inherent deficiencies. We therefore decided that we would not recommend that any such directive be signed by the Secretary at this time, and that we would attempt further to devise some effective means of control of profits within the Department. One feature of the proposal was revived several weeks later—namely, the requirement that the contractor submit statements as to the estimated cost of performance of his contract and other financial data in connection with the performance of Government contracts. Some time thereafter this did become the standard practice.

81. At this same time the War and Navy Departments and the War Production Board had been working upon the establishment in each of the three agencies of cost analysis sections, which would be able to point out profit danger spots and suggest administrative remedies therefor. On March 17, 1942, representatives of the Office of Procurement and Material who had participated in these discussions circulated a proposed outline of procedure for the establishment and workings of such sections. This suggestion provided for the close coordination of the proposed cost analysis sections in the three agencies, and provided further that the War Production Board would attempt to supply a check on the selection of contracts for cost analysis so that the program would not put an unmanageable burden upon the accounting offices of the three Departments. After further discussion of ways and means, the cost analysis sections were set up about [111] three weeks later. The War Production Board was to function primarily in analyzing the cost reports prepared by the War and Navy Departments.

82. In the latter part of March Messrs. Kenneth H. Rockey and Sylvan Coleman came into the Department at the Under Secretary's request to study the whole matter of excessive profits and closer pricing. Messrs. Rockey and Coleman went over the rather substantial data which we had by this time accumulated and spent considerable time with the contracting officers of the several Bureaus in reviewing contracting procedures and the methods then available for determining whether or not excessive profits were being earned. Both of them took a very active part in the discussions which were then occupying most of the time of the group studying the matter of excessive profits.

When the Navy Price Adjustment Board was established about April 20, 1942, Mr. Rockey was made its Chairman and Mr. Coleman was made a member of the Board.

83. In the course of our study, some of the cases of excessive profits enjoyed by subcontractors were brought to our attention. We learned of several instances in which the prime contractor with the Navy Department had given subcontracts to one of its subsidiary companies, and had included in its cost figures under the prime contract allowances for profits of subsidiary contractors. We sought to require representations by the prime contractor which would prevent any repetition of such practice. Of course, we recognized that any scheme of percentage-profit limitation tended to favor high profits for subcontractors; the prime contractor would not be interested in keeping subcontract costs or prices low, since the higher such costs or prices were, the higher the base on which his percentage of profits would be figured. Also, there were [112] some instances where work was subcontracted directly and the fee of the subcontractor was added to the fee of the prime contractor to make for double profits on the same work.

84. During the last week of March, 1942, the House Naval Affairs Investigating Committee held hearings on excessive profits being earned by several large Army and Navy contractors. These hearings were extensively reported in the newspapers, and the large profits earned by the Continental Motors Company and of Jack and Heintz received particular attention. The Naval Affairs Committee had received most of its data on these contractors from a joint audit which had therefore been undertaken by the Army and Navy. The hearings had the helpful

result of producing a number of meetings between Army and Navy representatives for joint consideration of the best means of limiting excessive profits. At such a meeting on March 25, 1942, it was concluded that each Department should have available an organization to which would be reported all cases wherein it was suspected that contractors were earning excessive profits. The meeting envisioned that these organizations would function about as follows:

a. All procurement officers would be advised of the establishment of the two organizations, and requested to refer to them for further investigation cases of excessive profits.

b. A conference would be called between the contractor and representatives of all Government agencies holding contracts with such contractor. At this conference, the profits would be considered with a view to obtaining for the Government a return of profits deemed excessive or a reduction of the contract price by the amount of such profits, whichever might be appropriate. [113]

c. The meeting contemplated that in the cases of recalcitrant contractors, resort might be had to compulsory orders under Section 9 of the Selective Training and Service Act; and further that in appropriate cases full publicity would be given to the excessive profits and the action taken.

The March 25th meeting further determined that immediate action along the lines indicated would be taken jointly by the services in the case of Continental Motors. In general, the War and Navy Departments were agreed that each case should be dealt with on an individual basis, although at the outset it might be advisable to approach

a group of contractors (perhaps those mentioned at the hearings of the House Naval Affairs Investigating Committee) and to deal with them in a body. It was agreed that the proposed action would be reported to the Congress to indicate the bona fide efforts being made by the War and Navy Departments to achieve answers to the problems of excessive profits. This meeting really represented the birth of the Price Adjustment Boards.

85. The War and Navy Departments thereafter discussed with the War Production Board this proposal to set up bodies to investigate war profits. Growing directly out of these discussions was the proposal that a Presidential Board be appointed to serve throughout the war for the purposes of studying the experience of other nations as to profit limitation, formulating a comprehensive program for the prevention of excessive profits, suggesting legislation and procurement policies as deemed appropriate, and dealing with special difficult cases. The proposal contemplated that Congress, the Army and Navy and other war procuring agencies would be able to look to such Board for guidance and advice. [114]

86. By the time this matter was brought up for consideration, however, H. R. 6790, the revival of the Vinson-Trammel percentage limitation, had been introduced (March 16, 1942); and Representative Case had introduced his amendment to H. R. 6868, providing for the renegotiation of contract prices to eliminate all profits above 6% (March 28, 1942). These proposals were discussed with representatives of the Army and the War Production Board, and representatives of the Navy presented to the House Naval Affairs Committee and to the Senate Finance Committee our views with respect to them,

and commented upon the several revisions of the renegotiation proposal which were submitted to us.

87. The passage of the Second War Powers Act, 1942, on March 27, 1942, afforded an additional weapon to the Navy Department and the other war procuring agencies in the investigation and determination of excessive profits. Title XIII of this Act allowed the agencies, when so authorized by the President, to inspect and audit the books and records of their contractors and to require such financial data as they desired. The President, by Executive Order 9127 dated April 10, 1942, delegated this authority of investigation and audit to the procuring agencies, subject to certain conditions. The Departments were enabled to go into the plant of any contractor and require the submission to them of all information as to profits.

88. The Cost Analysis Section and the Price Adjustment Board were formally organized in the Office of Procurement and Material about April 20, 1942, and were specifically called to the attention of all procuring officers of the Department by a memorandum circulated on April 24, 1942. [115]

89. The informal group which had preceded the formal establishment of these two organizations, the Bureau of Ships and the Cost Inspection Division of the Bureau of Supplies and Accounts, had meanwhile in the first four months of 1942 continued to readjust and renegotiate contract prices. The accomplishments of the Navy Department in reducing prices up through June of 1942 were summarized in the report of the House Naval Affairs Investigating Committee of July 22, 1943.[4] The Commit-

[4]H. Rept. No. 2371, 77th Cong., 2d Sess., pp. 26-32.

tee had obtained the names of specific contractors investigated and a great deal of the data on the excessive profits which they were enjoying, from the Departments. The Committee included in its report a summary of the "actual monetary savings to the Navy Department" as a result of renegotiation of contracts. It indicated that the Navy had effected such savings to the extent of some $88,000,000. While the Committee did not so indicate, the great bulk of this amount constituted reductions in contract price rather than returns of cash received by the contractors. Furthermore, as the Committee did point out, the renegotiations effected at that time would later show substantial results in lowering prices on new contracts for the munitions for which the original contracts had shown excessive profits. With respect to the ship repair and alteration contracts, the Committee remarked that refunds under these contracts amounted to $7,000,000 (which is to be compared with the $2,000,000 which had been recovered by the end of January, according to Captain Jones' testimony). As the volume of ship repair and alteration work had increased under these contracts, profits had expanded rapidly under rates which had been fixed in the absence of any adequate experience in this type of work. Under con- [116] tracts of this type, the Bureau of ships had been fairly successful in renegotiating profits to allow no more than 10% of costs (as compared to an average profit on such contracts prior to their readjustment of 30% of their cost of performance).

90. I am unable to present any concrete figures from the Navy Department as to the total cash refunds of profits by Navy contractors prior to April 28, 1942. Apparently all of the cash refunds were collected by means

of deductions from vouchers; no record had been kept of any such deductions, and it would be an interminable undertaking to examine the vouchers under each contract in the anticipation that they might reveal voluntary reductions in price. In addition, any recapitulation of the cash refunds would not show the whole picture, for most of the savings to the Government in the elimination of excessive profits were effected by means of price reductions.

c. Consideration of the Percentage Profit Limitation Proposals

91. Meanwhile, the Congress had been considering several proposals to impose a percentage limitation of profits upon Government contracts, and there appeared at the time to be a very strong chance that such a method of limitation would be enacted by the Congress. These proposals, to which the Navy procurement officers were unalterably opposed, naturally spurred the efforts within the Department to arrive at a solution to the profit limitation problem. On March 16, 1942, there had been introduced in the House H. R. 6790, which proposed among other things to limit profits on all Navy contracts to 6% of the cost of performance thereof. The bill was referred to the House Naval Affairs Committee, which held a number of hearings upon it in late March and April 1942. [117]

92. Both Mr. Forrestal and Col. Knox testified with respect to H. R. 6790. Mr. Forrestal called attention to the vast amount of auditing work which would be necessary to enforce any such limitation, and discussed our experiences under the Vinson-Trammell Act. The Secre-

tary, who testified on April 16, 1942, brought out the immense variety of factors which affected profits under a particular contract and the impossibility of any single cure for excessive profits applicable to all contracts. He pointed out one very important consideration which the Congress had not thus far emphasized—the importance of reducing costs to the Government as well as profits. As he suggested, high costs and reduced profits often went hand in hand and high costs could be much more expensive to the Government than high profits.

93. The Navy had had some experience in the difficulties of obtaining good accountants and auditors to handle the growing dollar volume of cost-plus-a-fixed-fee contracts. In early 1942, there were in the Cost Inspection Service of the Bureau of Supplies and Accounts, which audited costs under these contracts, some 2700 accountants (most of whom were stationed outside Washington); in addition there were a substantial number of accountants in the Bureau of Yards and Docks, which audited its own construction contracts. H. R. 6790 proposed to have costs under Government contracts determined by reference to Treasury Decision 5000 (the regulation under the Vinson-Trammell Act), which was then used as a guide for auditing costs under the cost-plus-a-fixed-fee contracts. The determination of costs was a burdensome and time-consuming job, and there were substantial differences of opinion as to what items were properly allowable costs. The complete post-audit of expend- [118] itures under the cost-plus contracts by the General Accounting Office, after audit by the services, further complicated the difficulties of administering the cost-plus-a-fixed-fee contracts. It seemed clear that there would not be enough accountants

in the nation to scrutinize costs under every Government contract, as contemplated by H. R. 6790, in the same way that costs were scrutinized under the cost-plus contracts.

94. H. R. 6790 was tabled in committee, for the renegotiation bill had been brought to the fore by the Congress. Section 403 of H. R. 6868, as reported out by the Senate Appropriations Committee, contained in subsection (f) a graduated range of percentage limitations to be applied to Government contracts of different size. Representatives of the Navy Department joined the representatives of the other war procuring agencies in discussing this subsection with the Senate Committee, which ultimately agreed that the percentage limitation feature should be deleted.

d. Maximum Price Controls

95. The matter of price controls upon munitions was considered by the Under Secretaries of the Navy and War and the Price Administrator in late 1941. They decided at such time that it would not be necessary to set up any formal machinery for handling differences of opinion between the armed forces and the Price Administrator with respect to prices, but that each problem would be handled as it arose. The situation was changed substantially by the approval on January 30, 1942 of the Emergency Price Control Act of 1942. The armed services had in the consideration of the bill which became the Price Control Act recommended that munitions be expressly exempted thereunder, but their suggestion [119] was rejected. The possible imposition of maximum price ceilings on munitions pursuant to this Act was a rather unsettling factor in the whole discussion of possible

methods for control of profits during the next several months. At the time of passage of the Act, the Price Administrator had not determined upon a policy as to the establishment of ceilings for the purpose of preventing war profiteering and of controlling prices under contractors for war matériel. On the day the renegotiation statute was approved—April 28, 1942—the Office of Price Administration issued its "Big Freeze" order, the General Maximum Price Regulation, and its Machinery and Parts Regulation (Maximum Price Regulation No. 136). The coverage of these regulations included a great many items of completed munitions and almost all components thereof, although certain specified munitions were to be exempted from the price ceilings established under the Regulations. Broadly speaking, the General Regulation fixed the price ceilings by reference to the prices in effect during March 1942, and required specific authority from the Office of Price Administration for the fixing of ceilings where there were no analogous March 1942 prices; and the Machinery and Parts Regulation fixed ceilings by reference to the prices in effect October 1, 1941, and also required specific authority from the Office of Price Administration in cases where there were no analogous October 1, 1941, prices.

96. The issuance of these regulations precipitated an immediate and prolonged discussion between the armed services and the Office of Price Administration as to the desirablity of fixing price ceilings for munitions and their components. As a stop-gap measure, the Price Administrator postponed application of the regulations to sales and deliveries under Army [120] and Navy contracts until July 1, 1942. In the latter part of May 1942, the Under

Secretary of the Navy established a liaison office in the Bureau of Supplies and Accounts, which was to integrate the price policies of the Navy Department and the Office of Price Administration insofar as possible.

97. It had been the position of the Army and Navy in all of their consideration of price control that it would be unwise and impracticable to apply price regulations to strictly military and naval equipment, and that attempts to do so ran the risk of impeding procurement of such equipment. It was felt that the services responsible for war procurement must have final power over prices; such services were charged with full responsibility for procuring the articles with which to fight the war, and proper prices might well be an inextricable element in such procurement. In the latter part of July 1942 the Under Secretaries of War and of the Navy notified the Price Administrator that while they recognized the necessity of adopting all possible means to prevent inflation, they felt that it was necessary to exempt military and naval supplies from the application of price ceilings. The Under Secretaries pointed out the difficulties inherent in effectively applying ceilings to munitions—e.g., the wide variety of conditions and uncertainties faced by contractors, the changes in specifications, inexperience of contractors, necessity of using all contractors and procuring all items regardless of cost. They further pointed out the probable impediment to production and procurement which the imposition of price ceilings would bring about, the undesirability of divided authority with respect to procurement, and the uncertainty and delay which would result from the application of the price regulations to Army and Navy contracts. Finally, they requested that "all

[121] articles which are designed and produced exclusively for military uses, and all subassemblies and parts of such articles which are themselves designed and produced exclusively for such military articles" be exempted from price regulation by the Office of Price Administration, with the exception of articles subject to regulation prior to June 30, 1942; that in questionable cases exemption be granted upon certification by the Secretary of War or of the Navy that the exemption was necessary for the prosecution of the war. The Under Secretaries pointed to the authority to renegotiate contract prices under the recently enacted renegotiation statute as a means at their disposal of controlling excessive profits and preventing inflation.

98. After further consultation, the Price Administrator responded in September 1942 by indicating that he would not extend maximum price control in the area of strictly military goods, provided he received assurances that the Army and Navy would use their powers to control both prices and profits in the exempted areas. He further indicated willingness to consider any requests for exemption of particular items at that time under formal price regulations. The Office of Price Administration agreed not to extend price control to sales of strictly military goods. It was understood that the exact line of demarcation between military and non-military goods would have to be more precisely drawn after conferences among the three agencies. The War and Navy Departments accepted the proposal as drawn by the Price Administrator, and agreed to furnish his Office with such information as it requested on the prices and procedures of the two Departments. Thereafter the armed services did establish

divisions which furnished to the Office of [122] Price Administration all information on prices requested by such Office.

99. Prior to the passage of the renegotiation statute, the top Navy officials in charge of procurement had spent a very considerable amount of time in seeking to evolve some answer to the extraordinarily difficult problem of limiting war profits while at the same time executing the vastly accelerated procurement programs.

100. There was virtual unanimity of opinion that the percentage limitation of profits was not a solution to the Navy problem—experience indicated that it was not effective and that it made contractors hesitant to take Government contracts. Indeed, it made many manufacturers want to become subcontractors rather than prime contractors. The limitation of adequate accounting personnel was an even more compelling practical reason for the rejection of this means of profit control. Similarly, we had neither the inclination nor the necessary personnel to extend the use of the cost-plus-a-fixed-fee contracts to fields wherein we were able to use fixed-price contracts. We knew from actual experience that exorbitant profits were being earned despite the recoveries under the excess-profits tax. The proposal to subject munitions to price ceilings had been seriously considered by the time of passage of the renegotiation statute, although the matter was not settled until the latter part of 1942.

101. The Navy Department was, then, in early 1942 in the position of opposing the known and theretofore attempted methods of limiting war profits, either because some of them were ineffective or because others would in

the opinion of those responsible for procurement seriously interfere with war production. We would quite frankly have preferred at this time to work out our own administrative solution to the problem of limiting profits under Navy contracts, primarily [123] through analysis of costs and closer pricing. The solution proposed by the Congress in the renegotiation statute, however, appeared to us to be a much better method than any alternative statutory method available. In retrospect, I believe that it is the better approach and that our earlier preference would not have solved the problem.

III. NAVY CONTRACT FORMS AND CLAUSES

102. The advent of the negotiated contract completely changed the form of the Navy contract and made necessary the use of much more intelligence and skill in the preparation of contracts.

103. Contracts awarded to the highest bidder after solicitation of competitive bids had all been based upon Forms 32 and 33 prescribed by the Procurement Division of the Treasury Department for all Government agencies. Such forms of contract, with their boilerplate provisions, were satisfactory only for simple deals, and proved quite inadequate for negotiated contracts. The first break away from these restrictive forms came in the preparation of construction contracts and contracts for the construction or installation of industrial facilities (in 1939 and 1940). In developing provisions for the facilities contracts—financing the contractor, purposes for which the facilities were to be used, rights of the parties upon the termination of the emergency period, and the like—it was obvious that the contract would have to be tailor-made

to fit the particular arrangement. Furthermore, in the course of drafting these various provisions to fit the procurement transaction, the boilerplate provisions were scrutinized and were often improved or made more appropriate. The grant of authority to negotiate certain contracts for vessels and supplies (in June 1940) further accelerated the process of [124] critical examination of the contract provisions and the drafting of intelligible new provisions to meet particular needs.

104. After enactment of the First War Powers Act, 1941, and the promulgation of Executive Order No. 9001, the Secretary removed entirely the restrictions of Form 32 in the preparation of negotiated contracts. The Secretary's directive of December 28, 1941, established a new internal Navy procedure for clearing contracts negotiated under the War Powers Act; in addition, it delegated to contracting officers complete discretion with respect to the form of such contracts, except for certain specified provisions required by statute or executive order. Under this delegation of authority, contracting officers were granted complete discretion to make advance, partial, and other payments on account of the contract price.

> * * * without limitation as to amount and irrespective of any provisions of law as to security, liens (except as [to the lien in favor of the Government as permitted by the Act of August 22, 1911, 34 U. S. C. 582]) or otherwise, except that advance payments should be carefully scrutinized to determine whether such payments are necessary for the satisfactory performance of the contract in accordance with the terms thereof and as much security by means of controlled accounts or otherwise shall be

provided for as may be expedient under the circumstances of each case.

The directive further specified:

> Such contracts [under the War Powers Act] may be made with or without competitive bidding as the respective contracting officers in their discretion may determine. There shall [125] be no limitation or restrictions as to form and substance of such contracts except [the contract clauses required by statute or executive order].
>
> * * * * * * * *
>
> The contracting officers are authorized to select such procedures in making contracts as are deemed best fitted to the purchases involved and the needs of the Navy.

105. At this time all instructions relative to contracts were in the form of individual directives by the Under Secretary to the Bureau Chiefs, who transmitted such instructions to the officers under them responsible for preparing contracts. Since the great majority of Navy contracts were made by the Bureaus in Washington, these directives could be rather informally issued and distributed. In general, they gave a wide degree of discretion to the Bureaus in the preparation of contract provisions. As we began to pay more close attention to prices and the elements which went into prices, it became necessary to issue more detailed instructions relative thereto; it was not until October 1943, however, that we were able to collect the contract directives in one place, arrange them, and issue them in a loose-leaf volume (the Navy Procurement Directives).

106. I shall summarize very briefly the more or less common Navy contract provisions prescribed in the first several months of 1942 for the determination or adjustment of prices or costs.

i. Changes

107. All Navy contracts included provisions for changes in the work covered thereby. The changes clause in all Bureau of Ships contracts was broader than that in other contracts made by the Navy. [126]

The Bureau of Ships clause provided:

> The Secretary of the Navy, at any time and without notice to the sureties, may make changes in this contract including the General Provisions, the plans or specifications of this contract, *within the general scope thereof.*

This type of clause had been in ships contracts since the 1880's. The broad language of the clause had, by construction, been somewhat limited in scope. The clause was eliminated about a year ago, and the ships contracts now contain provisions limiting changes to the work under the contract, as in the other Navy contracts.

108. With respect to changes in price upon a change in specifications or in the work under the contract, the more or less standard clause for fixed-price contracts provided that if the changes caused an increase or decrease in the cost of performing the contract, "an equitable adjustment" would be made and the contract modified in writing accordingly; facilities and cost-plus-a-fixed-fee contracts provided that upon the making of changes "an equitable adjustment of the estimated cost and the fixed

fee would be made and the contract modified accordingly." In the event of failure to agree upon a change in the fixed price or fixed fee, the matter was to be decided by the contracting officer pursuant to the disputes clause of the contract. The cost-plus-a-fixed-fee contracts for vessels provided specifically that if the estimated costs were changed as a result of changes in specifications, the fixed fee, which was stated to be about 7% of the estimated cost, should be changed by 7% of the change in the estimated cost.

ii. Payments

109. The contracts provided specific procedures for submission of invoices covering costs under cost-plus [127] and facilities contracts, and for prices of goods delivered under fixed-price contracts. These provisions varied substantially among the different types of contracts.

110. Fixed-price contracts for vessels called for partial payments as construction of the vessel progressed. The provisions for advance payments under fixed-price contracts specified that lien should be established in favor of the Government on the materials and property acquired by the contractor. In some instances controlled accounts were established, providing a check by the contracting officer upon the advance payments to the contractor; the advance payments clauses were at this time relatively simple as compared to clauses presently in use.

iii. Insurance and bonds

111. All contracts required the contractor to carry insurance on the property produced or acquired thereunder, and to carry workman's compensation and other third-party liability insurance with respect thereto. The

Government generally undertook to make the contractor whole for losses sustained in excess of the amounts covered by insurance taken out at the direction of the contracting officer.

112. After passage of the War Powers Act, performance and other bonds were largely dispensed with, although they were still required for certain standard supply contracts made by the Bureau of Supplies and Accounts. In any event, the performance, payment and similar bonds had never been of much use to the Navy. It had invariably proved impossible to obtain bonds at any cost in the cases where they were most needed. Generally the cost of bonds was high and the amounts of coverage in the case of large contracts were entirely inadequate to protect the Government. [128]

iv. Patents

113. Whenever patents were involved in the procurement, the standard clause of the Treasury Procurement contracts was used—the contractor agreed to hold the Government harmless against claims for infringement of patents in the performance of the contract. Some ships contracts contained the further requirement that the contractor not pay any sum for royalties or patent rights not included in the ordinary purchase price of parts embodied in the ships, unless and until duly so authorized by the contracting officer. No real progress was made in the matter of controlling royalties and other payments relative to patents under Navy contracts, and in drafting patent clauses which adequately protected the interests of the Government, until after the Procurement Legal Division was authorized to handle such matters in August, 1942.

v. Termination

114. Navy contracts (except Bureau of Ships contracts) at this time provided that in the event of cancellation for the convenience of the Government, the Navy would pay the contractor for all costs including a proper allocation of overhead expense to the contract, incurred up to the time of termination, plus an allowance of 6% or 7% profit on all such costs except purchases of materials and unfinished goods, for which the contractor was reimbursed at cost. This provision differed from the clause then used by the Bureau of Ships and the Army, which calculated the profit on the estimated extent of completion of the contract—the contractor was paid a percentage of the total profit equal to the percentage of completion. The use of any clause was a vast improvement over the practice in the first World War, when contracts did not contain any termination clauses. [129]

115. Navy contracts, other than ships contracts, also had included clauses authorizing termination for default, corresponding to the delays-damages clause of the old Treasury Form 32—if the Government terminated for default in delivery, it had the right to purchase the goods elsewhere and surcharge the contractor for any additional costs incurred by reason thereof by the Government.

116. After the First War Powers Act, the Navy dropped almost entirely the liquidated-damages clause. At this time there were frequent delays due to changes in specifications, material and labor shortages and the like, and it was often if not usually difficult to hold the contractor responsible for delays in deliveries. In addition,

contractors were extremely reluctant to take contracts containing such clauses. As the Navy was interested in getting the goods themselves, and not money damages, it determined to omit this clause generally.

vi. Guarantees

117. Most contracts in early 1942 contained a clause under which the contractor undertook to guarantee for a certain period the performance or durability of the articles covered by the contract in conformity with the specifications. This period varied from 3 months to a year or more. The contractor further undertook to correct or repair at his own expense any deficiencies or failures in the contract articles during such period. The ship contracts provided for trials, and adjustments and corrections by the contractor of the vessels during such trials. If the contract was a fixed-price contract, the contractor would often include large contingencies in his prices to cover possible expenses during the guarantee period. Since 1943 and 1944 the period of the guarantee has been shortened, and [130] the clause has been entirely eliminated in a few cases from Navy contracts.

vii. Escalator clauses in fixed-price contracts

118. Most fixed-price contracts for any substantial amount in late 1941 and early 1942 contained provisions for adjustment in price upon changes in material or labor costs. I should estimate that a majority in dollar amount of fixed-price contracts executed during this period contained escalator clauses. These clauses varied substantially in scope and in the index selected to measure increases in costs.

119. Some of the more primitive types of clauses had attempted to protect the contractor to the full extent of any cost changes. Almost all of the clauses in use at the time the renegotiation statute was being debated, however, attempted to protect the contractor not against all variations in the cost of labor and materials, but only against such changes in those costs as might be attributed to general changes affecting the entire national economy and thus wholly beyond the contractor's control. The basis for calculating changes in costs under the escalator clauses were in most cases indices representing wage levels (either general or for a specific industry) and material costs, usually indices published by the Bureau of Labor Statistics.

120. The most important determination in any escalator clause was the selection of the base to which the percentage of change in a selected index is applied in order to calculate the permitted adjustment of the contract price. The base selected varied widely among the several contracts, and was often exeremely complicated to compute—requiring in some cases substantial cost accounting. All of the escalator clauses are rather complicated to apply. The computations [131] under most of them were made by the Cost Inspection Service of the Bureau of Supplies and Accounts. We have subsequently discovered certain errors in the drafting and application of certain clauses, whereby increases were computed on costs including the price increases against which the escalator clause was designed to protect the contractor. We corrected such increases as they were called to our attention.

121. All escalator clauses are to some degree inflationary and are harmful in that respect. The device had

many disadvantages—it was used only because the Navy could not persuade contractors to take contracts on any other basis. Because of the uncertainties as to labor and other costs and the impetus to inflation which any war provides, contractors refused to run the risk of being tied to a fixed-price under a long-range contract. Escalator clauses were to be used only in long-term contracts. Our need for munitions was so great, however, that we could not quarrel very much over inclusion of such provisions. It must not be assumed that because an escalator clause was included in a contract, the price fixed therein did not include any allowance for contingencies. As has been made quite evident later, the price did include substantial allowances for contingencies. Furthermore, as I have indicated, the escalator clause was not a complete answer to the contractor's insistence upon protection. The clause purported to protect him only against certain direct labor and material price increases and did not protect him against other labor and material costs or other indirect costs which were subject to real fluctuation. The device was an imperfect one which it was necessary for us to adopt in order to speed procurement. Even with the elimination of the risks covered by the escalator clauses, contractors were able in some instances to make profits aggregating 50% or [132] more of cost as witness the ships contracts which I earlied cited.

122. On January 30, 1942, the Emergency Price Control Act was approved. The adjusted increases in contract prices under the escalator clause had to stop at any ceilings established by the Price Administrator on articles purchased or produced under the contract. At that time it was not known just how the Act would affect price

escalation; subsequently specific escalator clauses have been worked out for contracts covering certain materials subject to OPA ceilings.

IV. NECESSITY OF THE RENEGOTIATION STATUTE

123. Had the renegotiation statute not been enacted, I am convinced that Navy procurement would have been affected in the following ways, among others:

a. greater use of cost-plus contracts;

b. enforced use of mandatory orders to obtain munitions with respect to which agreement on price could not be reached;

c. reluctance on the part of contractors to take prime contracts, including preference for subcontracts; and

d. excessive profit and waste.

These probable results are to a large degree all tide together. We should have found it more and more difficult, I believe, to allow the large contingencies demanded by contractors in fixed-prices, and should therefore have been driven to a much wider use of the cost-plus-a-fixed-fee contract and the mandatory order. I have earlier described the lack of incentive to reduce costs which is inherent in the form of the cost-plus-a-fixed-fee contract, and the large number of auditing personnel required to determine allowable costs under such contracts. Mandatory orders constitute a somewhat ponderous means of procurement, and leave the [133] Government with the pricing problem still on its hands, plus possible court proceedings. There can be little doubt but that profits would generally have been larger in the absence of re-

negotiation. After a study of the complex problem of limiting profits in war to fair and reasonable amounts—the problem both as we faced it in the past and as we have faced it in this war—I know of no other type of profit limitation which can take into consideration the many diverse factors affecting the profits of different contractors and fairly adjust those profits, as adequately as does the renegotiation process. The growing Congressional and public criticism of exorbitant war profits in 1941 and 1942 would have resulted in an increasing reluctance on the part of manufacturers to take war contracts, and eventually in some form of profit limitation less palatable and less equitable than renegotiation. I am strongly of the opinion that, while the Government should consistently seek to improve its negotiation procedures in arriving at close prices, the problems of war procurement render impossible any completely satisfactory solution of the problem of initial pricing. Renegotiation, which affords a review of prices after the contractor has had the cost experience in the performance of his contracts, is to my mind an essential part of wartime procurement, today as well as in early 1942.

H. STRUVE HENSEL.

Sworn and subscribed before me this 16th day of July, 1945.

(Seal) LUCILLE HOLLAND,
Notary Public, D. C.

My Commission expires Sept. 1, 1946.

[Endorsed]: Filed Jan. 28, 1946. [134]

[Title of District Court and Cause]

AFFIDAVIT OF ROBERT P. PATTERSON

District of Columbia, ss

Robert P. Patterson, being duly sworn, deposes and says:

1. I am Under Secretary of War of the United States and have held that office, which was created by the Act of December 16, 1940, 54 Stat. 1224, since December 19, 1940. From July 30, 1940 to December 19, 1940 I was The Assistant Secretary of War.

2. By authority of various statutes and by various delegations of authority from The Secretary of War, I am, and have been both as Under Secretary and as The Assistant Secretary of War, charged with the supervision of the procurement of all military supplies and of other business of the War Department and the Army pertaining to production and procurement.

3. The statements made in this affidavit are based upon information acquired by me in my official capacity and which I believe to be true and accurate.

Preliminary Statement

4. Wartime procurement for the military establishment differs radically from procurement in times of peace. Speed in production at once becomes all-important. Industry is called upon to produce an entire complex of new products, constantly changing in design and purpose. Quantities of both old and new products, far beyond those previously manufactured, are suddenly demanded, and in the shortest possible time. For the production of

these needed items, [136] existing plants, machinery and equipment have to be converted from producing peacetime civilian goods to meet the different and expanded needs of the armed forces. Even the marginal producers have to be used in order to meet these needs. In addition, hundreds of new plants, new machinery and new equipment have to be constructed, installed, and put to work. The nation's manpower has to be reallocated, almost overnight, to adjust to the gaps caused by the transfer of millions from production to the armed forces, and to the springing up of new industries and new areas of production. Enormous dislocations in transportation, and in the supply of raw materials have to be ironed out.

5. The necessary result of this combination of circumstances is that the war procuring agencies cannot use normal methods of procurement. The pressing need for speed requires the abandonment of drawn-out negotiation and the careful surveys of all relevant factors which sound purchasing would otherwise require. Competition necessarily wanes and no longer offers an adequate guide to the prices which should be paid. Above all, the forecasting of costs of production becomes, in large measure, a matter of informed guessing rather than of real cost analysis. This is true in the case of new products, new plants, and new producers; it is likewise true, though perhaps in lesser degree, wherever the quantities to be manufactured are sharply increased over pre-war amounts. Accordingly, advance prices quoted in good faith by manufacturers in a large number of cases have little relation to costs actually experienced in the course of production. Furthermore, many manufacturers feel unable to quote firm prices without including reserves to cover many contingencies

the occurrence of [137] which might skyrocket their costs, and so overturn all their estimates.

6. These were the conditions of wartime procurement, after December 7, 1941, and the War Department had to force its procurement activities into their mold. Efforts were made, of course, to develop contractual devices which would minimize the paramount difficulty in estimating production costs. The cost-plus-fixed-fee contract was used where unavoidable, but this form has the disadvantage of removing financial incentives to efficiency and of imposing a heavy burden of auditing upon the Government and the contractor. Escalator clauses, permitting prices to be adjusted according to fluctuations in indices of labor and material costs, were also used but proved unworkable. Letters of intent, under which manufacture was commenced prior to the negotiation of a formal contract, helped to speed production, but could not, of course, solve the ultimate problem of decreasing costs and preventing excessive profits.

7. Shortly after the declarations of war, both the legislative and the executive branches of the Government realized that excessive wartime profits were certain to accrue unless counter measures were taken. The evil effect of such wartime excessive profit on the morale of the fighting forces and the civilian population, as well as the unnecessary financial burden upon the Government, could not be ignored. The example of the last war was still fresh. Many war contractors realized the dangers and inequities resulting from such excessive profit, and some of them made refunds of excessive profits or voluntarily reduced their prices. In the spring of 1942, the War Department developed cost analysis units to check,

so far as practicable, on production costs, and set up a price adjustment board [138] to negotiate with contractors for voluntary price reduction and refunds of past payments. Tentative policies as to what profits were excessive were established and meetings with contractors had. At the same time, there came into use contract clauses providing for the renegotiation or redetermination of contract prices after an initial period of production had laid a basis for the proper estimation of costs. We hoped that these means would keep incentives to efficiency alive and at the same time would tend to eliminate undue profits such as were then coming to light.

8. The Congress apparently felt, however, that these contractual measures, resting as they did upon the voluntary cooperation of a relatively small number of war contractors, did not provide enough certainty that excessive profits would be eliminated. The Vinson-Trammel Act, limiting profits on aircraft and ship construction, had been repealed in 1940, but an effort was made to revive it. In March, 1942, the War Department and the War Production Board opposed such legislation on the ground that a flat percentage profit limitation would impede production and would be unfair to many contractors and too generous to others. After the Case amendment imposing such a flat percentage limitation on profits from war contracts had been adopted by the House of Representatives late in March, 1942, the armed services and the War Production Board offered a substitute proposal giving statutory authority to the process of voluntary renegotiation which had been developing. Congress adopted the principle of renegotiation with which the armed services were in accord (rather than the principle of a

flat percentage limitation of profits), and it also endowed the procuring agencies with power to [139] determine excessive profits when no bilateral agreement could be reached with the contractor. I believe that this addition by the Congress of the power of unilateral action was a wise and a necessary one, and that without it renegotiation would not have accomplished anything like the results that have been achieved.

9. The purpose of this affidivit is to present the facts showing in greater detail, (a) the nature and extent of the procurement problems of the Army after the declaration of war, (b) the need for renegotiation and limitation of profits of war contractors and the steps which had been taken in that direction prior to the enactment of the renegotiation statute, and (c) what statutory renegotiation has accomplished.

The Army's Procurement Problems Subsequent to the Declaration of War

10. Immediately after the attack on Pearl Harbor, on December 7, 1941, the War Department's procurement program was sharply accelerated to meet the new requirements imposed upon the country and the Army by the sudden involvement of the United States in the war. The defense procurement program had been large, but the effort was minor in comparison with that necessitated by the demands of active warfare. Supplies, equipment, housing, ammunition, and weapons had to be secured, in the least possible time, for our rapidly expanding armed forces, and for the anticipated needs of a war to be fought on two sides of the globe. In addition, increased supplies for the nations with which we were allied had to be pro-

duced with the greatest possible speed. All phases of procurement were stepped up: production of the weapons of war, such as guns, planes, tanks; construction and equiping of camps; procurement of equipment and supplies for the troops; construction of plant facilities; [140] production of the means of communication and transportation.

11. The extent of the problem facing the procurement agencies can be judged from the goals set by the President in his message to Congress of January 6, 1942. The President stated:

> I have just sent a letter of directive to the appropriate departments and agencies of our government ordering that immediate steps be taken:
>
> First to increase our production rate of airplanes so rapidly that in this year 1942 we shall produce 60,000 planes, 10,000 by the way, more than the goal that we set a year and a half ago. This includes 45,000 combat planes, bombers, dive bombers, pursuit planes. The rate of increase will be maintained, continued, so that next year, 1943, we shall produce 125,000 planes, including 100,000 combat planes.
>
> Secondly, to increase our production rate of tanks so rapidly that in this year, 1942, we shall produce 45,000 tanks, and to continue that increase so that next year, 1943, we shall produce 75,000 tanks.
>
> Third, to increase our production rate of antiaircraft guns so rapidly that in this year, 1942, we shall produce 20,000 of them, and to continue that increase so that next year, 1943, we shall produce 35,000 antiaircraft guns.

> And fourth, to increase our production rate of merchant ships so rapidly that in this year, 1942, we shall build 8,000,000 deadweight tons, as compared with a 1941 completed production of 1,100,000. And finally, we shall continue that increase so that next year, 1943, we shall build 10,000,000 tons of shipping.

Illustrative of the tremendous undertaking facing both American industry and the procurement agencies is the fact that the total number of planes (military, commercial, and private) produced from 1903 to 1940 [141] was some 33½ percent less than the number scheduled for the year 1942 alone, and that procurement of planes for the Army during 1942 was over 250% greater than in 1941. For the fiscal year ending June 30, 1942, the money appropriated for War Department procurement and construction was more than six times the amount appropriated in the fiscal year 1941. One-third of the total was appropriated by the Congress in the first half of the fiscal year 1942, before the United States had been attacked; after Pearl Harbor, the Congress tripled the new procurement funds made available earlier in the fiscal year.

12. To fulfill the requirements of this expanded war program, a vast number of contracts had to be made, as quickly as possible, for supplies, weapons, and munitions of all kinds. Attached as Exhibit A is a chart (based on information furnished by the War Department Board) showing the number and dollar value of contracts for all types of war materials entered into each month from July 1941 through June 1942 by the various procuring agencies. The tremendous increase which occurred in January 1942 and continued through the remaining months of that fiscal year is clearly shown by this chart. In November,

1941, the total dollar value of such contracts was $1,506,-000,000; in December it jumped to $3,131,000,000; and in January 1942 to $9,456,000,000; in the remaining months of the fiscal year it never fell below $4,800,-000,000. The chart, it should be noted, understates both the total number of contracts and their total dollar value, since it excludes (1) contracts with a value of less than $50,000 (of which there were a vast number), (2) contracts for subsistence, and (3) construction contracts. An idea of the comparison between the total number of contracts entered into by the War Department prior to [142] Pearl Harbor and thereafter can be gained from the fact that the number of contracts for the fiscal year ending June 30, 1941, was 667,364, while that for the four months of July, August, September, and October 1942 alone was 1,408,141. All these figures concern only prime contracts, but the vast stimulating effect of this expanded volume of prime contracts upon subcontracting of all tiers is readily apparent. On December 31, 1941, War Department obligations for supplies and new capital facilities amounted to more than 9 billion dollars, but on June 30, 1942, they amounted to nearly 43 billion dollars. War Department expenditures for delivered supplies were nearly 4 billions on December 31, and were more than 13 billions on June 30. In the last six months of the fiscal year ending June 30, 1942, War Department contractual activity and the delivery of supplies were four times greater than in the first six months. Some conception of the vast scope of the procurement activity of the armed services after the attack on Pearl Harbor can be gained from the fact that the total expenditures of the War and Navy Departments for the one fiscal year ending June 30, 1942 ($22,905,000,000) considerably ex-

ceeded the total military and naval expenditures of the Government from 1789 through the end of World War I.

13. To meet these accelerated demands, the armed forces had to call, in largest measure, upon private industry which, prior to December 7, 1941, was devoting only 25% of its total production to defense work, and of this amount, by far the largest proportion resulted from the use of existing idle capacity and the establishment of new facilities rather than from the conversion of existing facilities geared to civilian production. Little stoppage of civilian pro- [143] duction had occurred prior to December 1, 1941. If the imperative needs of the armament program were to be satisfied, wholesale conversion of existing production facilities to a war economy would have to occur. By the end of 1942, the proportion of manufacturing industry devoted to war production amounted to upwards of 45%, and presently this percentage is estimated at 60%. Some of this increase is, of course, attributed to the continued construction and use of new facilities, but the greater part of it has come from conversion of existing facilities since December 1941.

14. The armed forces were thus forced to grapple with major difficulties stemming from (a) the greatly increased demands for supplies of all types, (b) the accelerated program requiring immediate production, and (c) the urgent and rapid conversion of the great mass of American industry to war work and the large-scale use of new facilities. Other acute problems were caused by (d) the demand for new products not previously manufactured, and by the constant modification of specifications to reflect improvements in design or changing needs, and (e) by the current uncertainty in the amounts of matériel to be

procured, and the grave difficulties in the supply and cost of labor and matériel which were daily arising at that time:

(a) The greatly increased demand for supplies made the accurate forecasting of costs very difficult. Starting costs were bound to be higher than those incurred after mass production had begun; but the extent to which quantity production would bring a sharp drop in costs could not be estimated either by the Government or by contractors, and the latter were naturally very cautious in prophesying about their future costs. This was frequently true in the case of standard articles previously manufactured in small quan- [144] tities and was uniformly true in the case of new products.

(b) The urgent need for placing orders and starting production as soon as possible placed the importance of speed far above thorough analysis or careful negotiations. Time was of the essence, and the Government personnel entrusted with negotiation and procurement were, of necessity, too few and too overburdened to follow the normal procedures of careful procurement. There was simply no time to collate and check the cost information which in less abnormal times would be required; and, of course, such cost information pertinent to wartime production was frequently nowhere obtainable.

(c) The conversion of peacetime facilities to war work meant that cost data for the new production were unavailable, even for established plants. And in the hundreds of new plants producing war goods, only the roughest guess as to the costs of manufacturing which would be experienced during actual production could be made. Marginal producers, and those with no experience

with the product or with the greatly increased quantities they would be called upon to produce, had to be used.

(d) War on the scale and under the conditions we are fighting calls for unceasing development, production, use, and improvement of countless new supplies and weapons. The demands of amphibious warfare, for instance, led to the development of amphibian boats and cargo carriers. The mechanization of modern warfare forced the development and rapid production of such items as tanks and motorized gun carriers as well as of the weapons employed against them: anti-tank guns and grenades, armor-piercing ammunition, self-propelled mounts, and anti-aircraft guns. The spurt and rapid changes in aircraft development [145] are common knowledge, as the growth of communication and detection devices. Changes in design and material also frequently resulted from shortages of previously used components. The use of steel had to be severely limited wherever a less critical material could be substituted. Motor vehicle cargo bodies, for example, were converted from steel to wood. Acute shortages of copper and brass led to other changes in accepted design. Great use was made of plastics in order to release critical metals. This activity can be partly epitomized in the summary statistic that during the fiscal year 1942 approximately 1,200 Army specifications were reviewed, and revised or approved; and about 425 specifications were completely cancelled.

(e) Material and labor shortages were acute in the spring of 1942. The consequence was that it was generally difficult, except within the widest limits, to establish accurate schedules for the production of supplies. The Army's requirements had to be drastically reduced,

in the months from February to June 1942, because of these factors, and these changes and reductions were reflected in the War Department's procurement program. An equally important consequence was the difficulty of gauging both the costs and the time of performance because of the shortages and anticipated rise in the costs of labor and materials.

15. All these factors made advance pricing a haphazard process in which the war procurement agencies could put little trust. The situation with which we were faced is well summarized in the following two statements (one by a Government agency and the other by a large war contractor) with which I am in full accord and which I believe to be an accurate description of the procurement situation as it existed after the coming of the war. The following is an excerpt from the Introduction to the Renegotiation Regula- [146] tions issued by the War Contracts Price Adjustment Board:

> The war program creates problems of procurement and production unprecedented in scale and complexity. War materials of all kinds are required in enormous quantities with the greatest possible speed. The munitions program expanded with such rapidity that contracting officers were hard pressed to place contracts in time to meet the accelerated requirements. In order to avoid delay, they had to make contracts without adequate data. Obtaining the material was the first issue. Many contractors were asked to produce articles which had never been produced before and which were subject to frequent change. Others were asked to produce articles which were new to them. Still others, who had produced

articles in small quantities, were asked to produce them in amounts far beyond their previous experience. Quantities needed, the rates of delivery and specifications had often to be revised in the light of experience and the demands of war. Shortages of material, priorities, and allocations increased the uncertainty of production.

Besides these circumstances, contractors and contracting officers were frequently unable to make an accurate forecast of costs on which to base prices. During the period of transition, costs were certain to be high. New facilities had to be obtained, new personnel employed and trained to new methods and new sources of supply developed. How long this would take was itself uncertain. After the contractor got into production, greater efficiency, improved methods, and increased volume could be expected to reduce costs sharply.

The following are excerpts from a report by the General Motors Corporation, in September 1943, to the War Department Price Adjustment Board: [147]

With the advent of the war-production program, the automatic check on pricing policy which had been furnished by competition during peacetime could no longer be relied upon. The Corporation was obliged to undertake the manufacture of many products which were entirely foreign to its own past operations. In many instances, these products had not been produced by any manufacturers in the volume contemplated by the war program. As a result, there was no ready-made yardstick against which the Corporation

could measure proposed prices, and it became necessary to rely largely upon the judgment of the several general managers of the operating divisions and the Government contracting officers, as well as whatever limited experience might be available from other producers, as to the reasonableness of the cost estimates and prices submitted. In certain cases, the only practical solution of the pricing problem has been to insert clauses into contracts providing that prices would be reviewed as soon as representative cost experience had been obtained as a result of volume production.

Under these circumstances, it has been impossible to predict with any degree of certainty what the operating results of particular contracts might ultimately be. It therefore became imperative for the Corporation to establish as soon as possible a basic pricing policy which would take into account these unusual conditions and insure that proper and effective pricing control would be obtained. In establishing this policy, the primary considerations were twofold. First, it was recognized that in producing war material, the checks of normal competition had been removed, and that the peacetime conception of desirable profit margins, as previously described, had to be modified. Second, it was considered essential to maintain, as far as possible, the Corporation's normal method of doing business on a decentralized basis, with primary [148] responsibilty for contracting, pricing and production resting upon the divisional general managers, subject to the over-all general policies of the Corporation. * * *

> The policy of taking contracts on a fixed-price basis whenever practicable was adopted (despite the increased risk) because of the greater incentive to efficient operation afforded by this type of contract as compared with the cost-plus-fixed-fee type. However, it was recognized that the divisions were undertaking the production of war materials which were not only new to the Corporation, but had not been manufactured by any one on a "mass-production" basis. Therefore, there was always a possibility that initial cost estimates on certain contracts, even though they appeared reasonable to the divisional general managers and to the Government contracting officers at the time the estimates were prepared, might turn out to be higher than actual costs of production as volume increased, when designs were changed, and as manufacturing experience was obtained. * * *

16. A graphic illustration of the way in which all the factors of uncertainty listed above combined to make the advance estimation of costs extremely difficult in 1941 and 1942 is furnished by the experience of the General Motors Corporation. That company is one of the largest peacetime manufacturers of automotive products, its accounting and auditing procedures are superior, and its ability to forecast the costs of manufacture of automotive products would far outrun that of most other producers. Nevertheless, as the company itself fully realized (see paragraph 15 above), even it was in no position to estimate its costs with any acceptable margin of accuracy. General Motors accepted contracts containing redetermination provisions, under which an original price based on the best available estimate of costs was established, with revisions

made after [149] the costs of a preliminary run of 1,000 units and a test run of a further 1,000 units were available. The price for the remainder of the contract was determined on the basis of the test run. The results obtained under two of these contracts were as follows:

a. *Medium Tank* (per unit):

Original price (middle of 1941)	$67,401
	Estimated redetermined value
Preliminary run (March 1942-December 1942), 1,000 units (including preproduction expenses)	$50,947
Test run (December 1942-February 1943), 1,000 units	39,079
Remainder (February 1943-August 1943), 1,053 units	39,285

b. *Light tank* (per unit):

Original price (set during 1941)	$45,000
	Estimated redetermined value
Preliminary run (April 1942-October 1942), 1,000 units	$34,625.99
Test run (October 1942-December 1942), 1,000 units	26,972.96
Remainder (December 1942-February 1943), 1,266 units	28,347.09
2nd Preliminary run (Feb. 1943-June 1943), 1,000 units	24,658.65

c. The following table illustrates the sharp decrease in costs following a sharp rise in quantity of production, and the gaining of manufacturing experience. The figures represent revisions of General Motors Corporation's price for the *.50 cal. heavy barrel machine gun:*

	Units	Price
Original price (Aug. 1941-Dec. 1941)	1,308	$868.07
1st revision (Jan. 1942-Mar. 1942)	2,830	632.55
2nd revision (Apr. 1942-May 1942)	3,247	532.00
3rd revision (May 1942-Sept. 1942)	14,717	413.60
10th revision (June 1943-Aug. 1943)	3,500	300.59

17. Faced with these difficulties of estimating production costs and also with the pressing need for speed in procurement, the War Department naturally chose to emphasize, after December 7, 1941, the speedy placing of a mass of contracts. Pressure to obtain supplies was already great before the attack [150] on Pearl Harbor, but thereafter it was made even clearer to contract officers that they were expected to place the increasing load of orders assigned to them with the least possible delay. The war would not rest to allow proper negotiation, and the War Department made it clear that the primary goal was speed in obtaining the necessary equipment and supplies. Illustrative is P. & C. General Directive No. 8,[1] issued January 14, 1942 (attached hereto as Exhibit B), which stated that "price is a secondary consideration as compared with speed and efficient production," and "speed in placing orders now authorized is important, but speed of production as a whole during the next 18 months is of even greater importance. * * * War calls for the same boldness and imagination in procurement as it does in meeting combat conditions in the field." War Production Board Directive No. 2, March 3, 1942, placed "primary emphasis * * * upon securing delivery in the time required by the war program." P. B. General Directive No. 34, dated April 9, 1942, which coordinated War Department rules concerning purchases, reiterated the WPB

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[1]P. & C. General Directives were issued, under my direction, by the Purchases and Contracts Branch of the Office of the Under Secretary of War; this branch later became the Contract Division, and the directives were entitled CD General Directives; in March 1942, the unit became the Purchases Branch, Procurement and Distribution Division, Headquarters, Services of Supply, and the directives were entitled PB General Directives.

standards and added that in giving effect to these policies "it is recognized that it may be necessary to purchase at other than the lowest price offered."

18. To implement this policy of speedy procurement, and at the same time to adjust, as best it could, to the conditions of wartime production, the War De- [151] partment adopted several procurement devices and policies.

a. Peacetime War Department procurement, with certain exceptions, was accomplished through advertising for bids. At the beginning of the general emergency it was foreseen that this method would prove impracticable for emergency procurement, and the Act of July 2, 1940 (Public No. 703, 76th Congress) authorized contracting without advertising for national-defense purposes. This authority was widely used for the purchase of such supplies as aircraft and tanks, but in many fields it was believed that the Government could still avail itself of the safeguards of letting contracts by advertising. After the declaration of war, however, it was seen that negotiation would have to supplant advertising almost entirely. The increased need for speed in procurement, the necessity of employing even high-cost producers, the unfamiliarity of most contractors with the products or the quantities they were called upon to manufacture, and all the uncertainties of the period described above, combined to render advertising unsuitable to wartime procurement. Accordingly, on December 16, 1941, the Secretary of War issued a directive broadly extending the authority to make procurements without advertising, and by directive of December 17, 1941 (P. & C. General Directive No. 81) I ordered "that the authority to place orders without advertising be utilized in all cases where that method of

procurement will expedite the accomplishment of the war effort." The First War Powers Act of 1941 (approved December 18, 1941), and Executive Order No. 9001, issued December 27, 1941, confirmed and extended the power to make contracts by negotiation, and thereafter the use of that method became dominant in Army procure- [152] ment. On March 3, 1942, War Production Board Directive No. 2 required all of our war contracts to be negotiated (unless specific authority to advertise were granted), and on March 4, 1942, this rule was made effective in the War Department by CD General Directive No. 25.

b. Speed in procurement and the utilization of all available producing facilities required decentralization of procurement, increased subcontracting, and widespread distribution of war orders. (1) Prior to December, 1941, considerable decentralization had been effected; the limits of the dollar amounts of contracts which could be approved by echelons below the office of the Under Secretary of War had gradually been raised to $500,000. On December 16, 1941, the Secretary of War directed a sweeping decentralization of procurement, and on the next day I issued P. & C. General Directive No. 81, empowering the chiefs of the supply arms and services to approve contracts up to $5,000,000, and authorizing them to decentralize still further. This directive stated that "In order to enable orders to be placed in the quickest possible time, it is desired that chiefs of supply arms and services decentralize to their field agencies the actual work of procurement and the placing of awards and contracts to the greatest extent compatible with efficiency and proper safeguarding to the public interest." (2) Subcontracting

had also been fostered from the beginning of the emergency, since it was foreseen that full defense production could not otherwise be achieved. With the outbreak of the war, P. & C. General Directive No. 8, dated January 14, 1942 (Subject: "Selection of Contractors for war production"), strongly emphasized this need and required procurement officials to insist upon subcontracting: "The heavy procurement program and need for speed in pro- [153] duction make vital the best utilization of every facility." (3) For the same reasons, the policy of the widespread distribution of defense orders was adopted. This policy was partially crystallized in War Production Board Directive No. 2, March 3, 1942, which stated "that contracts shall be placed so as to conserve, for the more difficult war-production problems, the facilities of concerns best able, by reason of engineering, managerial, and physical resources, to handle them. Accordingly, contracts for standard or other items which involve relatively simple production problems shall be placed with concerns, normally the smaller ones, which are less able to handle the more difficult war-production problems."

c. Letters of Intent were used early in the emergency to expedite production. Through use of this form of contract, the contractor could begin manufacturing the needed supplies before agreement had been reached on a definite price, or the full extent of the procurement determined. The slightly different letter contract form was authorized in May and June 1941, for the same purpose. On December 17, 1941, there was issued at my direction, P. & C. General Directive No. 88, which ordered the more extensive use of letter contracts "in the interest of expediting procurement." On January 16, 1942, revised let-

ter contract forms were issued, and on January 13, 1942, a letter purchase order (to replace the letter of intent) was issued and its use directed by contracting officers "where the necessity for the supplies is so urgent as to render prior negotiations in respect to price, schedule of deliveries, or other terms impracticable, or where negotiations in respect thereto have failed to result in an agreement" (P. & C. General Directive No. 5). These policies were emphasized to the contracting personnel by the various supply arms [154] and services. For instance, the Signal Corps directed (April 20, 1942) that in no case in which time was of the essence should the selection of a satisfactory contractor be delayed to await agreement on the price; "if immediate agreement cannot be reached on the price, a letter purchase order or a letter of intent should be issued to the contractor selected, so that production can be initiated pending the negotiation of price." Pursuant to these directions, these contract forms were used in great number throughout the War Department.

19. Contractual devices were also adopted in an attempt to overcome the insistence of contractors on covering all the contingencies of wartime production into their prices.

a. One means, of course, of eliminating the probability of excessive profits and of tying the contract price to actual costs is the cost-plus-fixed-fee form of contract. The Act of July 2, 1940, authorized the use of this form, and War Department directives of the same day permitted its use when "deemed necessary in the interest of the United States in order to accomplish or expedite the national defense program." But this form of contract has never been favored by the War Department, for the

reasons that it offers no financial incentive to control or reduce costs and that it requires an inordinate amount of auditing and paper work. However, its use was found necessary in some cases. P. & C. General Directive No. 81, dated December 17, 1941, provided that "contracts will be negotiated on a cost-plus-a-fixed-fee basis only when the use of that form of contract is essential." Later directives have continued and strengthened that policy and have consistently urged the conversion of cost-plus-fixed-fee contracts to the fixed-price basis. [155]

b. Another attempt to meet the objections of suppliers who felt that they could not quote firm prices because of anticipated rises in material and labor costs, were escalator—price adjustment clauses. On September 17, 1941, the War Department approved a price adjustment (escalator) article to be used "only in exceptional cases where the facts justify their use." (P. & C. General Directive No. 48.) It was expressly required that all contracts containing the escalator clause also include an article providing for termination of the contract for the convenience of the Government. On December 17, 1941, P. & C. General Directive No. 86 issued certain amendments, mainly concerning indirect labor and material costs, to the approved clauses. Copies of these two directives (including the escalator clauses) are attached hereto as Exhibits C and D. Escalator clauses present some of the undesirable features of cost-plus contracts. Their administration is complex, and they require extensive accounting and auditing.

These devices were not favored by the War Department, for the reasons I have stated. By themselves, they were not satisfactory or effective methods for confining

profits to reasonable levels or for decreasing production costs. Other means of attaining these ends had to be developed.

Need for Renegotiation and Profit Limitation and Measures to That End

20. At the beginning of the limited emergency in 1939, the only applicable statutory limits on profits from the sale of military or naval supplies were contained in the Vinson-Trammel Act of March 27, 1934, as amended (relating to naval vessels) and the Merchant Marine Act of 1936, as amended (relating to [156] construction of merchant ships). The Act of April 3, 1939, extended percentage profit limitation to cover Army aircraft contracts. The percentage of profit allowed to contractors was lowered to approximately 8% by the Act of June 28, 1940, but the Second Supplemental National Defense Appropriation Act, 1941, enacted September 9, 1940, provided that as to aircraft the old limitation of 12% was to prevail.

21. Manufacturers of war products, particularly aircraft manufacturers, asserted that they could not take Government contracts in the face of these profit limitations. Many subcontractors were reluctant to work for them under Government prime contracts at 8% or 12% when they could make 15% or 20% working for civilian manufacturers. Moreover, many subcontractors were unwilling to take contracts which involved the necessity of keeping elaborate cost records subject to Government audit. It was therefore decided that the Vinson Act would have to be suspended, and that an excess profits tax should be levied. Accordingly, the Second Revenue Act of 1940, containing the excess profits tax, suspended

the profit limitation statutes applicable to Army and Navy contracts entered into after December 31, 1939, or uncompleted on that date by contractors and subcontractors subject to the new excess profits tax. Thereafter, until the passage of the Sixth Supplemental National Defense Appropriation Act of 1942, the only statutory provisions concerning war or defense contracts were those of the excess profits tax.

22. From the beginning of 1942, officials of the War Department were aware that a necessary result of the unstable purchasing conditions of war procurement would be the accumulation by many contractors and [157] subcontractors of excessive profits which would not be siphoned off by the existing tax legislation. Publication of financial reports of war contractors for 1941 indicated the tremendously increased profits derived from the more limited defense program. The decision of the Supreme Court in United States v. Bethlehem Steel Corporation, 315 U. S. 289, decided in February 1942, reemphasized the extent of the profits which had been made in World War I. On March 23, 1942, the Naval Affairs Committee of the House of Representatives conducted a hearing on the defense profits of Jack & Heintz, Inc. (Hearings before the Committee on Naval Affairs, House of Representatives, 77th Cong., 2d Session, pursuant to H Res. 162, Vol. 1), and the information divulged at that hearing on the exorbitant profits made by that concern received wide publicity. Other information of the same character was developed by the Naval Affairs and other Congressional Committees and was made available to the War Department. The War Department and at least one of the supply services (the Signal Corps) es-

tablished rudimentary cost analysis units to study the manufacturing cost, of Army suppliers, and preparations were made to review and check contract prices.

23. The need for eliminating excessive profits obtained from war production is as paramount as it is obvious. Excessive profits mean increased tax and war loan burdens on the public and increased pressure toward inflation. Undue profit margins are also a cushion for wasteful and costly manufacture. Perhaps most important is the destructive effect of excessive war profits upon the morale of men in the armed services and of civilian workers. The sharp reaction to war profits which occurred after World War I is eloquent testimony of the significance of this factor. [158]

Voluntary Renegotiation

24. During the defense period, prior to December 7, 1941, there had been a certain number of voluntary refunds and price reductions by defense contractors. In June and July, 1941, War Supplies, Ltd., the Canadian Government corporation through which the United States purchases in Canada, agreed to refund to the War Department all profits over 10% of cost. In October 1941, it was found advisable to issue a directive on the taxable character of sums received by contractors but voluntarily refunded to the United States. P. & C. General Directive No. 54, October 7, 1941, stated that: "From time to time a contractor with the Government discovers that his profits are larger than he had at first estimated, and desires to refund the excess to the United States. Under these circumstances, certain contractors have hesitated least in making the refund they subject themselves to a tax penalty, either through paying or having paid income

taxes on the profits received or through being forced to pay a gift tax on any refund." But voluntary renegotiation took on much greater scope in early 1942.

25. On the same day that they appeared before the Naval Affairs Committee (March 23, 1942), officials of Jack & Heintz, Inc. met with procurement officials of the War Department for the purpose of reviewing the Company's Army contracts. It was agreed that the contractor would reduce its prices on its various contracts, totaling somewhat over $50,000,000, by an over-all amount slightly in excess of $10,000,000. On March 28, 1942, our procurement officials met with officials of Continental Motors Corporation to review that company's aircraft contracts. After negotiations, the company voluntarily agreed to reduce its prices on existing contracts by a total of $40,000,000. A third [159] such meeting, on April 6th, with the Sperry Corporation resulted in a voluntary reduction of about $100,000,000.

26. Other voluntary renegotiations were effected in the first quarter of 1942. A number of contractors expressed their willingness to adjust their prices to reflect actual costs, as they developed, and to restrict their profits to proper wartime levels.

a. Prior to May, 1942, General Motors Corporation had made voluntary price reductions running into more than $200,000,000, according to its own figures. One example follows: In a contract made in August 1941 for 8,000 aircraft engines, the Allison Division of General Motors included contingency reserves in the unit prices but stated that if excessive profits developed during the course of performance it would be willing to grant reductions on undelivered engines. In December 1941 and

January 1942, the War Department received information that costs were lower than anticipated. Renegotiation discussions were begun with the contractor, and on March 30, 1942, it offered to refund approximately $20,000,000 to the Government.

b. In June 1941, Republic Aviation Corporation undertook to manufacture 125 P-43A airplanes, over a period of some ten months, at a stated unit price. The Government's negotiators believed that the agreed price might lead to excessive profits. The contractor's representatives, though believing that the price was not too high, orally agreed that if profits in excess of 10 or 11 percent were made, the company would either voluntarily reduce its contract price or would construct an experimental plane for the Government without cost. On December 10, 1941 the contractor informed the Government that its profit on the contract would probably exceed the stipulated amount and [160] suggested that it furnish the experimental airplane. The War Department was not interested in the experimental airplane, and after further cost figures indicating excessive profits became available, the contractor offered an acceptable voluntary price reduction of $1,445,370.00.

c. In April 1942, information became available that Beech Aircraft Corporation was making a profit of approximately 33% on its airplane contracts. On April 16th and 17th the Company agreed to review the contract prices, and shortly thereafter price reduction agreements were consummated.

d. Similarly, in April 1942 discussions were begun with Cessna Aircraft Corporation, Bendix Aviation Corpora-

tion, and some other contractors, which resulted in price reductions.

27. In March 1942, the War Department determined to establish formal price renegotiation machinery, and plans were drawn for a Price Adjustment Board to negotiate with contractors for reduced prices where excessive profits had been or were likely to be secured. On March 27, 1942 there was prepared in the War Department a tentative memorandum outlining the policy and procedure of the putative War Department Price Adjustment Board. The purpose of the Board, its operating policies, and method of operations were set forth, as well as a list of factors to be considered in determining the reasonableness of profits. A copy of this memorandum is attached as Exhibit E. To be noted is the similarity between the factors listed as governing profits reasonableness in this memorandum, in the Joint Statement by the War, Navy, and Treasury Departments and the Maritime Commission, dated March 1943, and in the Renegotiation Act, as amended and reenacted in the Revenue Act of 1943. This memorandum of March 27th was not published nor was it [161] issued officially, but use was made of it in voluntary renegotiations conducted by the War Department. At the meeting of March 28th with Continental Motors Corporation (see paragraph 25 above) this memorandum was read to the contractor's representatives as a preliminary and tentative statement of War Department policy on excessive profits.

28. Title XIII of the Second War Powers Act, enacted March 27, 1942, conferred upon the Government authority to inspect the plants, books, and records of war contractors. On April 10th, the President issued Execu-

tive Order 9127 ("Designating the Departments and Agencies to Inspect the Plants and Audit the Books and Records of Defense Contractors under Title XIII of the Second War Powers Act, 1942") in order "to prevent the accumulation of unreasonable profits, to avoid waste of Government funds, and to implement other measures which have been undertaken to forestall price rises and inflation." Under this order, the cost analysis units in the War Department were expanded and strengthened, and a new basis was laid for price adjustment boards.

29. The Under Secretary of War, the Under Secretary of the Navy and the Chairman of the Maritime Commission (with the approval of the Chairman of the War Production Board) agreed to establish price adjustment boards within the three agencies in order to advise and assist procurement officials "in securing adjustments or refunds in instances where it is determined that costs or profits of contractors are, or may be, excessive for any reason." A copy of this memorandum is attached as Exhibit F. Plans for such a board in the War Department had been proceeding meanwhile and on April 25th, Lieutenant General Brehon Somervell, Commanding General of the Services of Supply, formally established such a price [162] adjustment board, with my approval. A copy of his memorandum is attached as Exhibit G.

30. A corollary to the establishment of these procedures for voluntary renegotiation, without specific contractual or statutory basis, was the development of contract clauses looking toward the renegotiation or redetermination of prices after partial or complete performance. The problem was submitted to a committee of representatives of the War Production Board, the War De-

partment and the Navy Department and resulted in the preparation of two contract clauses. One, known as the "redetermination clause," was designed to permit automatic adjustment downward in price on the basis of actual cost experience during a "test run" early in the performance of the contract. The other contract provision, originally known as the "renegotiation clause," was designed to permit adjustment of the price either upward or downward in the light of actual cost experience after part performance, as soon as reasonably reliable cost estimates were feasible. These articles were promulgated for us in War Department contracts by P. B. General Directive No. 31, dated March 13, 1942, a copy of which is attached as Exhibit H. One of the purposes of the new clauses can be gained from the opening statement of the directive that "It is essential to eliminate all delays in the production of items immediately required which result from the time required for the negotiation of fixed price contracts."

Statutory Proposals

31. The Congress was, of course, also concerned with the probability that excessive profits would be made by many war contractors, despite the excess [163] profits tax. The disclosures at committee hearings and the profit information available was thought to require legislative action. In March 1942, a bill was introduced to establish a rigid profit limitation of 6% on war contracts. On behalf of the War Department, I opposed this proposal before the Committee on Naval Affairs of the House of Representatives (March 19, 1942), and Mr. Donald Nelson opposed it on behalf of the War Production Board

(March 24, 1942). (Hearings before the Committee on Naval Affairs, House of Representatives, 77th cong., 2nd Session, on H. R. 6790, pp. 2473-2475, 2577-2578.) Mr. Nelson and I pointed out that the bill, if enacted, was likely to interfere with war production, especially by delaying the conversion of small business to war work and also by forcing the increased use of the cumbersome and wasteful cost-plus-a-fixed-fee contract. We also pointed out that a fair percentage of profit was not solely a function of the cost of performance but depended upon such factors as turn-over, volume of business, amount of invested capital, financial structure, time of performance, and contribution to increased efficiency. Depending upon these factors, and particularly upon dollar volume of business, a 6% profit might be far too large or far too small. Attention was also called to the impossibility, under the flat percentage system, of allowing the recoupment of losses. At the same time, I stressed to the Committee that the War Department recognized its "plain duty to take every practicable step to prevent contractors from obtaining excessive and unconscionable profits," and I described the cost analysis and price adjustment projects which were then being formulated (see pars. 27-29 above), and the price redetermination and re- [164] vision clauses which had been authorized (see par. 30 above). This profit limitation bill, to which I expressed the War Department's opposition, was not acted upon by the House of Representatives.

32. On March 28, 1942, Congressman Case offered on the floor of the House of Representatives two profit-limitation amendments to the Sixth Supplemental National Defense Appropriation Bill. His first proposal was that

no final payment on a war contract be made by the Government "until the contractor shall have filed with the procuring agency a certificate of costs and an agreement for renegotiation and reimbursement satisfactory to the Secretary of War or the Secretary of the Navy, as the case may be." This amendment was subject to a point of order, and Congressman Case then offered a substitute amendment providing that final payment was not to be made "to any contractor who fails to file with the procuring agency a certificate of cost and an agreement for renegotiation of contract and reimbursement of profits in excess of 6 per cent." This amendment was adopted by the House of Representatives without debate. Mr. Case has stated that his proposals were modeled, in part, upon the renegotiation clauses developed by the procurement agencies (see par. 30 above). See Hearings before the Subcommittee of the Committee on Appropriations, U. S. Senate, 77th Cong., 2nd Sess. on H. R. 6868, pp. 89-92, 211-2.

33. At a hearing held on March 31 and April 1, 1942, by a subcommittee of the Senate Committee on Appropriations, on the Sixth Supplemental National Defense Appropriations Bill for 1942, representatives of the Government stated the objections to the Case amendment, as it then stood. General Somervell reviewed the factors making adequate pricing impossible [165] in many cases and described the price adjustment procedures which had already been established in the War Department. The committee was informed that a Cost Analysis Section and a Price Adjustment Board had been set up and were at work and tentative policies and procedures had been laid down (Hearings pp. 24-25). The approved "redetermina-

tion" and "renegotiation" contract articles were also described to this subcommittee and their use explained. General Somervell, Mr. Donald Nelson of the War Production Board, and other representatives of the procurement agencies again stated the objections to an inelastic profit-limitation provision of the type of the Case amendment. It was pointed out that the amount and rate of profit should depend—out of fairness to contractors and to furnish the proper incentive to reduce costs—on a number of factors, such as rapidity of turn-over, development costs, production time, money invested in the business, risks incurred, efficiency of production; a flat percentage limitation lumping all contractors together would not only be unfair to many and too generous to others but is subject to the very defects which have placed the cost-plus contract in disfavor; moreover, the statutory percentage of profit which is intended to be a maximum tends to become a minimum and contractors believe that they are entitled to receive that rate of profit.

34. The Senate Subcommittee requested the procurement agencies to supply a substitute for the Case amendment. On April 2, 1942, General Somervell submitted a proposal on behalf of the War and Navy Departments and the War Production Board. A copy of this substitute proposal is attached as Exhibit I. The suggestion was based on the theory that if [166] every contract price could be reexamined by the parties in the light of actual experience under the contract, it should be possible to eliminate the bulk of excessive profits. Section 403, as finally enacted, differs in many respects from our proposal, but it retains the central principle that a fixed percentage limitation on profits should not be established.

35. The War Department has consistently opposed the substitution of a 100% excess profits tax in place of the renegotiation statute, for the same reasons for which we disapprove a flat percentage limitation on profits from war contracts. Our views are stated at length in the report of the Hearings before a Subcommittee of the Senate Committee on Finance on Section 403 of Public Law No. 528, September 29-30, 1942, 77th Congress, 2d Session, and the Hearings before the Committee on Naval Affairs, House of Representatives, pursuant to H. Res. 30, June 1943, 78th Cong., 1st Sess. pp. 997-1000. The Introductions to the Renegotiation Regulations of the War Contracts Price Adjustment Board and to the Joint Renegotiation Manual approved by the Joint Price Adjustment Board also contain statements on this point with which the War Department is in accord. In brief, the major objection to a 100% excess profits tax is that it would remove all incentive to reduce costs or promote efficiency, and in this respect would tend to increase the cost of war procurement through the waste of manpower and resources so as to counterbalance any gain in tax collections.

36. The War Department has found that the Renegotiation Act is the most satisfactory and effective method of eliminating excess profits on war contracts. The Department has vigorously opposed the repeal of the statute. [167]

Contracts on Which Final Payment Had Not Been Made on April 28, 1942

37. At the end of April 1942, the following amounts were obligated for contracts, but unexpended, by the Navy Department and the three major procurement services of the War Department:

Army Air Forces contracts, over	$16,700,000,000
Ordinance Department contracts, over	10,000,000,000
Engineers contracts, over	4,000,000,000
Navy contracts, over	18,000,000,000
Total, over	48,700,000,000

These figures concern only the agencies listed; they do not include subcontracts; nor do they include sums actually paid prior to April 28, 1942, on contracts on which final payment was not made until after that date. The figures do, however, include sums owing on some contracts exempt from renegotiation under the statute, but such sums are relatively small.

38. On the whole, it is certain that, on April 28, 1942, there were outstanding uncompleted war contracts in a total figure considerably in excess of 50 billion dollars which would have been exempt from renegotiation if the statute had not been made applicable to contracts existing on April 28th but with respect to which final payment had not been made by that date.

39. It is impossible to give more than the most general data concerning the life of the uncompleted contracts in existence on April 28, 1942. The average time required for the construction of the major types of projects (cantonments, airfields, ordnance plants) being constructed

under the supervision of the Corps of Engineers in April 1942 was from 7 to 18 months. A substantial proportion of the Ordnance contracts placed during the first four months of 1942 extended for over six months; some of these contracts con- [168] templated production extending over a period as long as two years. The Navy Department estimates that at least one-third of its funds which were obligated but unexpended on April 30, 1942, represented contracts requiring 12 months or longer for performance.

Excessive Profits Eliminated By Renegotiation

40. As of September 19, 1944, 34,966 contractors had been assigned for renegotiation with respect to fiscal years ending during the calendar year 1942. As of the same date, 35,200 contractors had been assigned for such renegotiation with respect to fiscal years ending during the calendar year 1943. Of the cases assigned with respect to fiscal years ending in the calendar year 1942, relatively few remain uncompleted; and the renegotiation agencies are well along toward completion of the cases assigned with respect to fiscal years ending in the calendar year 1943.

41. As of September 22, 1944, in 7,949 cases excessive profits had been determined by agreement between the contractor and the Government, and at that date in 207 cases excessive profits had been determined by unilateral action by the Government without the agreement of the contractor. Thus, 97.5% of the cases in which excessive profits had been determined involved bilateral agreements in which the contractor joined. These figures do not include the cases, of which there are a large number, in

which no excessive profits were found or in which the renegotiation proceedings were cancelled as the result of information indicating no excessive profits. It should be noted, too, that the number of contractors affected by the bilateral agreements exceeds the number of 7,949, since many of these agreements affect groups of parent and subsidiary corporations. [169]

42. It is impossible at the present time to give complete figures as to the dollar volume of the sales covered by the cases in which excessive profits have been determined. As of September 16, 1944, in the 7,733 cases concluded by bilateral agreement or unilateral determination (excluding Army construction contracts), the aggregate renegotiable sales of the contractors affected (prior to adjustment for excessive profits eliminated) were $30,975,405,000. Excessive profits eliminated in these cases amounted to $3,586,652,000. In addition, approximately $57,000,000 in excessive profits had been recovered from construction contractors assigned to the Chief of Engineers for renegotiation. These figures do not take account for reductions in Federal taxes occasioned by the elimination of excessive profits through renegotiation.

43. The figures in the preceding paragraph do not include excessive profits eliminated (a) by refunds made to contracting officers prior to and unrelated to statutory renegotiation, (b) by reduced prices with respect to future performance or deliveries under existing contracts, or (c) by reduced prices under new contracts. No statistical data are available as to the amounts of excessive profits so eliminated or prevented, but they have been substantial, and run into many hundred millions of dollars.

44. The data contained in paragraphs 40 to 43 cover renegotiations carried on by all agencies and not merely those in which the War Department is interested.

Renegotiation Procedure

45. From the very beginning of statutory renegotiation by the War Department, the attempt has always been made to secure the full cooperation of the contractor in the process of renegotiation. It has been [170] the uniform practice to explain the purposes, policies, and methods of renegotiation to contractors and to elicit their participation both in the furnishing of information and in the drawing up of an agreement as to excessive profits. Although Title XIII of the Second War Powers Act, 1942, grants the Government certain powers to secure the pertinent records and data, on which renegotiation must be based, from recalcitrant contractors, we have always sought to obtain this information voluntarily, and without unduly hampering the contractor's activities. Similarly, although the statute empowers the renegotiation agencies to determine excessive profits unilaterally, it has always been our policy to renegotiate, in the literal sense, and to seek a bilateral agreement with the contractor, whenever possible.

46. In most cases, renegotiation in the War Department (for fiscal years ended on or prior to June 30, 1943) was conducted initially by Price Adjustment Sections of the Technical Services (e.g., Ordnance Department, Signal Corps, Chemical Warfare Service) and the Army

Air Forces. If the initial renegotiation proceedings did not result in an agreement with the contractor, or if a bilateral agreement was proposed in cases where the contractor's gross sales were more than $10,000,000, the case was always referred to the War Department Price Adjustment Board. I am advised that the Board, in every case in which a contractor requested a meeting with representatives of that Board, accorded the contractor that opportunity. Until April 12, 1945, if an agreement could not be reached between the representatives of the Board and the contractor, the case was then referred, together with a full report, to me as Under Secretary of War. It was my practice to refer such case, for initial review, to one of my principal assistants, not otherwise connected with renegotiation. This assistant invariably allowed the contractor, upon the latter's request, to meet with him before he made any [171] recommendation to me; and in this meeting the contractor could present any pertinent material not previously furnished and discuss the matter from the contractor's point of view. I personally made the final determination that excessive profits had been made in every case in which a unilateral determination was signed by me. The last hearing conducted by an assistant of mine under this procedure was held on April 12, 1945. On April 11, 1945, I delegated to the Chairman of the War Department Price Adjustment Board the power to make unilateral determinations under the Renegotiation Act. I am informed that, pursuant to that delegation, the War Department Price Adjustment Board has es-

tablished a Determination Committee consisting of the six War Department members of the Board. That Committee, as I am informed, has granted and will grant contractors an opportunity for a meeting with two members of the Committee, appointed by the Chairman for that purpose, before a final determination is made in any case where the Committee disapproves the determination recommended by the representatives of the Board who met with the contractor initially. In sum, opportunity is always afforded the contractor for discussions with representatives of the renegotiating agency and the presentation of pertinent data and argument. No unilateral determination has ever been made without the contractor's having been offered the opportunity, at some stage and in substantially all cases at several stages in the renegotiation process, to present his views and discuss the matter.

Robert P. Patterson
ROBERT P. PATTERSON.

Sworn to and subscribed before me this 3rd day of August, 1945.

[SEAL] EDWARD L. DAVIS,
Notary Public, D. C.

My Commission Expires July 14, 1946. [172]

EXHIBIT A

W. P. B. RECORD OF MONTHLY AWARDS OF PRIME WAR SUPPLY CONTRACTS

Date	Total	Aircraft	Ships	Ordnance	All others
		Number of contracts			
1941					
July	1,124	40	40	202	842
Aug.	1,352	62	77	264	949
Sept.	1,476	78	68	223	1,107
Oct.	1,824	97	49	305	1,373
Nov.	1,566	94	67	321	1,084
Dec.	1,885	116	63	384	1,322
1942					
Jan.	3,612	132	156	836	2,488
Feb.	3,656	136	165	710	2,645
Mar.	4,188	162	161	765	3,100
Apr.	4,866	187	197	795	3,687
May	3,597	114	126	459	2,898
June	3,657	143	171	439	2,904
		Value (millions of dollars)			
1941					
July	1,057	92	129	551	285
Aug.	1,842	688	237	636	281
Sept.	1,335	386	159	436	353
Oct.	2,404	1,264	107	569	464
Nov.	1,506	261	288	461	495
Dec.	3,131	985	406	1,150	589
1942					
Jan.	9,456	2,435	2,092	4,015	914
Feb.	7,301	3,628	893	1,891	889
Mar.	5,343	1,440	728	1,842	1,333
Apr.	5,715	1,234	1,014	1,808	1,659
May	4,843	1,337	759	1,530	1,216
June	5,299	937	1,249	1,709	1,404

EXHIBIT B

WAR DEPARTMENT
OFFICE OF THE UNDER SECRETARY
Washington, D. C.

January 14, 1942.

PC-E-400.13 (Procurement).
P. & C. General Directive No. 8.
Memorandum for: The Chief of the Air Corps.
The Chief, Chemical Warfare Service.
The Chief of Coast Artillery.
The Chief of Engineers.
The Chief, National Guard Bureau.
The Chief of Ordnance.
The Quartermaster General.
The Chief Signal Officer.
The Surgeon General.

Subject: Selection of contractors for war production.

1. The heavy procurement program and need for speed in production make vital the best utilization of every facility. As a limited number of facilities are able to undertake precision work, care must be exercised in allocating only such work to them, each plant to undertake the highest caliber of work its equipment can produce.

2. In awarding prime contracts, great weight must be placed upon the contractor's agreement to subcontract a high percentage wherever this is feasible. Unless secondary facilities are thus put to work on the simpler components, difficulty will later be encountered in placing prime contracts calling for precision work. The best

results will be obtained by insisting upon such subcontracting at the time of the award of [174] the prime contract as efforts to have prime contractors subcontract simpler components at a later date may be only partially successful after work has been started.

3. In many cases requirement of subcontracting will add to the total cost. Price is a secondary consideration as compared with speed and efficient production. Reasonable increase in price which will speed the program through subcontracting is justified. Because of the increase in price, subcontracting should be taken into account in making the award and should be provided for in the prime contract, where possible, rather than to assume that it can be arranged after the award has been made.

4. Speed in placing orders now authorized is important, but speed of production as a whole during the next 18 months is of even greater importance. Accordingly, under our present decentralized procurement policy the chiefs of the supply arms and services and their district procurement offices must exercise their best judgment in the matters mentioned in paragraphs 1, 2 and 3 above. War calls for the same boldness and imagination in procurement as it does in meeting combat conditions in the field.

By direction of the Under Secretary of War:

(S) JOHN W. N. SCHULZ,
Brigadier General, U. S. Army,
Director of Purchases and Contracts. [175]

EXHIBIT C

WAR DEPARTMENT
OFFICE OF THE UNDER SECRETARY
Washington, D. C.

September 17, 1941.

PC-L 162 (Escalator Clause).
P. & C. General Directive No. 48.
Memorandum for The Chief of the Air Corps.
The Chief, Chemical Warfare Service.
The Chief of Coast Artillery.
The Chief of Engineers.
The Chief, National Guard Bureau.
The Chief of Ordnance.
The Quartermaster General.
The Chief Signal Officer.
The Surgeon General.

Subject: Price Adjustment Clause

1. Price Adjustment articles (escalator clauses) will be included in supply contracts only in exceptional cases where the facts justify their use. In determining the justification for the inclusion of such a clause, the following factors, among others, should be given consideration:

a. The inclusion of an escalator clause should result in a lower contract price than if such a clause were not included. Before consenting to the inclusion of an escalator clause in a contract, the contracting officer should satisfy himself that the contractor has not included in the contract price any amount to cover probable increased direct labor or direct materials costs.

b. The time required for the performance of the contract should be such as to make it im- [176]

possible to forecast with reasonable accuracy the extent of changes in the direct labor or direct materials cost under the contract. Ordinarily the time of performance should not be less than six (6) months.

c. The contract should be of sufficient amount to warrant the administrative expenses which would be incurred in administering the escalator clause. As a general rule, contracts for less than $100,000 would not warrant such expenditure.

2. Attached hereto are copies of the Price Adjustment article (escalator clause) as approved by the Under Secretary of War on September 13, 1941, for use in supply contracts hereafter entered into where it has been determined that an escalator clause should be included. Any deviations from this form will be made only after approval in each case by the Under Secretary of War. Requests for such approval will be accompanied by a detailed statement of the facts and reasons justifying such deviation.

3. All contracts containing this escalator clause will also contain an article providing for termination of the contract for the convenience of the Government.

4. It is desired that the foregoing instructions be communicated promptly to all contracting agencies in your branch.

By direction of the Under Secretary of War:

(S) JOHN W. N. SCHULZ,
John W. N. Schutz,
Brigadier General, U. S. Army,
Director of Purchases and Contracts.

Incls.
cys. Price Adjustment Clause. [177]

FORM OF ESCALATOR CLAUSE APPROVED BY THE UNDER SECRETARY OF WAR, SEPTEMBER 13, 1941

Article..... *Price Adjustments.*

The total contract price stated in Article..... is subject to adjustment for increases or decreases in direct labor and direct material costs in accordance with the following method:

(a) Labor.

(1) Upon the basis of labor costs prevailing in ....., 194.... (hereinafter called the base month) the direct labor cost is estimated to be $..... Direct labor, as used herein, refers only to the labor of employees of the Contractor performed directly on, and properly chargeable to, the supplies manufactured hereunder, excluding, but without limitation, all executive managerial, supervisory, technical, professional, office, clerical and sales employees, but including working foremen, gangbosses and strawbosses. The Contractor represents that the above estimated cost is based upon a schedule, approved by the Contracting Officer, of the kinds or classes of jobs or occupations to be charged as direct labor under this contract, and that the estimate includes only such jobs or occupations. In computing the actual direct labor cost for the purposes of paragraph (a) (2) and (a) (3) hereof, the cost of kinds or classes of jobs or occupations not listed in this schedule, a copy of which is attached hereto, shall not be included.

(2) After deliveries under this contract have been completed, the estimated direct labor cost set forth above shall be apportioned into direct labor cost quotas for the

consecutive three-month periods (hereinafter called "quota periods") beginning on the first [178] day of ....., 194....,[1] and on the first day of each third month thereafter. This apportionment shall be made by dividing the actual direct labor cost properly charged to this contract during each quota period by the total actual direct labor cost under the contract, and by multiplying the percentage thus obtained for each quota period by the total estimated direct labor cost. The result shall be the direct labor cost quota for that period.

(3) Upon the basis of the average hourly earnings in the durable goods manufacturing industries compiled by the United States Department of Labor, Bureau of Labor Statistics, the Government will determine the average hourly earning for each quota period by adding the average hourly earnings for each month of such quota period and dividing their sum by three, and calculations will be made of the percentage of change of such average hourly earnings for each quota period in comparison with the average hourly earnings for the base month. The labor cost quota for each quota period will then be multiplied by the percentage of change for such quota period, and the result will be applied as an increase or decrease in the contract price; *Provided,* That the total of such increases in the contract price shall not exceed the amount by which the total actual direct labor cost exceeds the total estimated direct labor cost, and that the total of such decreases in the contract price shall not exceed the amount by which the total actual direct labor cost is less than the total estimated direct labor cost.

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[1]The month during which the contracts is executed or performance is commenced, whichever is earlier.

(b) Materials. [179]

(1) Upon the basis of materials costs prevailing in the base month, the cost of direct materials which the Contractor will purchase for the performance of this contract, excluding materials to be used which the Contractor has on hand or for which firm price commitments have been obtained by him (hereinafter call "direct materials to be purchased hereunder"), is estimated to be $..... (hereinafter called "estimated adjustable materials cost"). Direct materials as used herein refers only to those materials which go into and become a component part of the Contractor's finished product and which, under the cost accounting system regularly employed in the Contractor's plant, are accounted for by direct charges to the particular contract. The Contractor represents that the above estimate is based upon a schedule, approved by the Contracting Officer, of the kinds and classes of "direct materials to be purchased hereunder." In computing the actual cost of "direct materials to be purchased hereunder" for the purposes of paragraphs (b) (2) and (b) (3) hereof, the cost of kinds or classes of materials not listed in this schedule, a copy of which is attached hereto, shall not be included.

(2) After deliveries under this contract have been completed, the "estimated adjustable materials cost" shall be apportioned into materials cost quotas for the quota periods as defined in paragraph (a) (2) above. This apportionment shall be made by dividing the total actual cost of "direct materials to be purchased hereunder" into the portion of such cost properly charged to the contract during each quota period, and by multiplying the percentage thus obtained for each quota period, by the total

"estimated adjustable materials cost." The result shall be the materials cost quota for that period. Direct materials shall be [180] charged to the contract for the quota period during which the price therefor is determined as between the Contractor and the materials supplier; *Provided,* That where commitments are obtained by the Contractor for future deliveries at a firm price in excess of the market price prevailing at the time such commitments were obtained, such materials shall be charged to the contract for the quota period during which delivery is to be received by the Contractor; *And, Provided further,* That with respect to materials which are not identifiable with the purchase commitments under which they are acquired, determinations as to (1) whether the materials employed in the performance of this contract were on hand at the time the contract was executed, and (2) the quota period to which the materials are to be charged and the amount of such charge shall, with the approval of the Contracting Officer, be made on the basis of the accounting system regularly employed in the Contractor's plant.

(3) The Government will average for each quota period the index numbers of wholesale prices for .....[2] compiled by the United States Department of Labor, Bureau of Labor Statistics for the three months included within such quota period, and calculations will be made of the percentage of change of such average index numbers for each quota period in comparison with the index numbers for the base month. The materials cost quota for each quota period shall then

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[2]The index for the commodities group which includes the items making up the major portion of the "direct materials to be purchased hereunder."

be multiplied by the percentage of change for such quota period, and the result will be applied as an increase or decrease in the contract price; *Provided,* That the total of such increases in [181] the contract price shall not exceed the amount by which the actual cost of "direct materials to be purchased hereunder" exceeds the total "estimated adjustable materials cost," and that the total of such decreases in the contract price shall not exceed the amount by which said total actual cost of "direct materials to be purchased hereunder" is less than the total "estimated adjustable materials cost."

(c) General.

(1) For the purpose of determining increases or decreases in contract prices, rates of change in average hourly earnings and rates of change in the materials index number will be calculated to the nearest one-tenth of one percent, and there shall be used the latest figures which shall have been issued by the Bureau of Labor Statistics up to the close of the fourth month following the last quota period under this contract.

(2) Payments for increases, or deductions for decreases in the contract price, resulting from the operation of this article, will be made after the completion of the calculations of price adjustments in accordance herewith; *Provided,* That the Government may, from time to time during the life of the contract, make partial payments on account of such increases, subject to such requirements as a condition precedent to such payments as the Contracting Officer may provide; *Provided, further,* That in this event such partial payments shall exceed the amount due to the Contractor by the operation of this article, the

Government shall deduct the amount of such excess from any further payments due under this contract.

(3) Should the Contractor, during the performance of this contract, on account of subcontracting, or otherwise, depart from the production methods upon which the estimates and schedules of direct labor and direct [182] materials costs were based to such an extent that the use of such estimates or schedules will operate to produce an unfair adjustment of the contract price, a corresponding correction in such estimates or schedules may be made by mutual agreement between the Contractor and the Contracting Officer. In the event of disagreement with respect to the need for or extent of such correction, the procedure of Article 12 (Disputes) shall apply.

(4) If this contract is terminated pursuant to any provision thereof the contract price shall be adjusted as provided above, except that for the purposes of paragraphs (a)(2), (a)(3), (b)(2), and (b)(3), the terms "estimated direct labor cost" and "estimated adjustable materials cost" shall be understood to refer to that part of such costs which corresponds to that proportion of the supplies contracted for which is completed and delivered by the Contractor, and the terms "actual direct labor cost" and "actual cost of direct materials to be purchased hereunder," shall refer only to that part of such costs which is properly chargeable to the supplies completed and delivered.

(5) The Contractor shall file with the Contracting Officer, not later than sixty days after the completion of the performance of the work under this contract or after its termination, a statement of the actual direct labor costs and the actual costs of "direct materials to be pur-

chased hereunder," certified as correct by an independent public accountant approved by the Contracting Officer, showing the amounts of such costs properly chargeable during each quota period and, in case of termination, the amounts properly chargeable to the supplies completed and delivered. In determining the total actual direct labor cost and the total [183] actual "direct materials to be purchased hereunder," and in determining the amounts thereof to be charged in each quota period, the Contractor may, subject to the approval of the Contracting Officer and to the limitations of paragraph (b) (2), employ the accounting system regularly employed in the Contractor's plant. Such statement shall be deemed prima facie correct. The Government reserves the right to audit the books and records of the Contractor, to determine the accuracy of such determinations and certification, and to obtain any information in connection with the operation of this Article. All information obtained from the Contractor's records shall be treated as confidential. The Contractor shall preserve all the books, papers, and other accounting records pertaining thereto; *Provided,* that if the Contractor at any time after the lapse of three years following the completion or cessation of work under the contract, desires to dispose of said books, papers, and accounting records, he shall so notify the Secretary of War, or his duly authorized representative, who shall either authorize their destruction or notify the Contractor to turn them over to the Government for disposition. [184]

EXHIBIT D

WAR DEPARTMENT
OFFICE OF THE UNDER SECRETARY
Washington, D. C.

PC-L 162. December 17, 1941.
P. & C. General Directive No. 86.

Memorandum for: The Chief of the Air Corps.
The Chief, Chemical Warfare Service.
The Chief of Coast Artillery.
The Chief of Engineers.
The Chief, National Guard Bureau.
The Chief of Ordnance.
The Quartermaster General.
The Chief Signal Officer.
The Surgeon General.

Copy to: The Judge Advocate General—for information.

Subject: Amendment to Price Adjustment Clause.

1. Reference is made to the form of escalator clause approved by the Under Secretary of War on September 13, 1941, accompanying P. & C. General Directive No. 48.

2. It has been determined that the escalator clause should be amended so as to provide for adjustments on account of changes in pay-roll taxes, and therefore, the approved form of escalator clause will be amended by adding the following provision thereto as paragraph (c) (6):

> If after the date on which the prices herein were quoted, the Congress or any state legislature, shall impose, remove, increase or decrease any pay-roll tax required to be borne by the [185] contractor and

directly applicable to or measured by the pay-rolls of the contractor hereunder, then the rate of such newly imposed tax, or the net increase or net decrease in the rate of a previously imposed tax, shall be multiplied by that portion of the actual direct labor cost which is subject to such increases or decreases in the tax or taxes, and the result shall be paid the contractor under this paragraph.

3. It has also been determined that the escalator clause should be amended so as to provide for adjustment on account of changes in indirect labor and indirect material costs. Accordingly, the following amendments to the approved form of escalator clause will be made:

a. As a second sentence to Paragraph (a) (1), add the following:

"It is also estimated that the indirect labor cost attributable to this contract is .....% of such estimated direct labor cost."

b. Add the following as Paragraph (a) (4):

"The total increase or decrease to be paid or deducted under Paragraph (a) (3) shall be multiplied by .....%[1] and the result shall be applied as a further increase or decrease in the contract price, as an adjustment for the indirect labor cost under this contract."

c. Add the following as the second sentence in Paragraph (b) (1):

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[1]The percentage of indirect labor cost stated in Paragraph (a) (1).

"It is also estimated that the indirect materials cost attributable to this contract is .....% of such estimated direct materials cost."

d. Add the following as Paragraph (b) (4):

"The total increase or decrease to be paid or deducted under Paragraph (b) (3) shall be [186] multiplied by .....%[2] and the result shall be applied as a further increase or decrease in the contract price, as an adjustment for the indirect materials cost under this contract."

4. In negotiating the estimated direct labor cost, the percentage thereof represented by indirect labor cost, the estimated direct material cost, and the percentage thereof represented by indirect material cost, the Contracting Officer should consider, among other things, the following factors:

a. The amount of the estimated direct labor cost and the amount of the estimated direct materials cost should be limited in accordance with the definitions of direct labor and direct material costs contained in paragraphs (a) (1) and (b) (1) of the escalator clause, and should not include any amounts for indirect labor or indirect material costs;

b. The total of the estimated direct labor cost and the estimated direct material cost together with the amounts obtained by the application of the percentages set forth for indirect labor and indirect materials, should bear a reasonable relation to the total contract

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[2]The percentage of indirect materials cost stated in Paragraph (b) (1).

price. In any case where the difference between the total of these amounts and the contract price does not leave a reasonable margin to cover profit, rent, depreciation, taxes, and similar costs not included in the labor or material costs factors, it will be apparent that the estimates are too high, and should be accordingly reduced.

By direction of the Under Secretary of War:

(S) JOHN W. N. SCHULZ,
Brigadier General, U. S. Army,
Director of Purchases and Contracts. [187]

EXHIBIT E

WAR DEPARTMENT
PRICE ADJUSTMENT BOARD
Policy and Procedure

Purpose of the Board.

The Price Adjustment Board will serve as a focal point for the review of contracts existing between the War Department and its contractors. Its duties will be to make sure that the War Department is doing an economical job of purchasing and that contractors are not making excess or unreasonable profits on war orders. In its review of contractor profits the Board will endeavor to eliminate from contractor cost calculations ex*h*orbitant items of whatever nature.

The Board will assist the Services in securing an adjustment in contract prices that will accomplish the foregoing objectives.

The Board will also serve contractors who feel that their contract prices are such that a likelihood exists that

they will make excessive or unreasonable profits. It will invite war contractors finding themselves in this position to consult with it for the purpose of arriving at a fair and equitable voluntary adjustment.

Operating Policies.

The following principles will be observed by the Price Adjustment Board in dealings with contractors:

1. The Board will endeavor to arrange for a readjustment in contract price or to obtain a return of payments made pursuant to a contract to the extent which will result in limiting the contractor to a fair and reasonable profit.

2. In judging the reasonableness of profit, the Board will consider: [188]

(a) the total profit made by the contractor before allowance for federal income and excess profit tax.

(b) the amount of profit per unit based on estimated or actual cost.

3. In determining the estimated or actual cost per unit of performance of the contract, the Board will give consideration to all items of cost, including the following:

A. Factory Cost:

1. Direct materials
2. Direct productive labor
3. Direct engineering labor
4. Miscellaneous direct factory charges
5. Indirect factory expenses

Total Factory Cost

B. Other manufacturing cost

C. Miscellaneous direct expenses

D. Indirect engineering expenses

E. Expenses of distribution, servicing and administration

F. Guarantee expenses

4. The Board will in general be guided by the cost accounting system regularly utilized by the contractor, except that the Board will, in appropriate cases, disallow salaries, bonuses or other expenditures which are clearly excessive.

5. In determining the amount of profit to be viewed as reasonable, the Board will give proper consideration the following:

A. The first factor in determining the attitude of the Board toward the contractor will be based on the contribution that the contractor has made [189] and is making to the completion of the war production program.

B. Whether the contract is performed in whole or in part with facilities furnished by or financed by the Government.

C. The amount of invested capital employed by the contractor in the performance of the contract.

D. The ratio between this investment and sales volume.

E. The period of time required to perform the contract.

F. The complexity or simplicity of the manufacturing operations involved.

G. The presence or absence of exceptional risks to be borne by the company.

H. The degree of skill and management and organization required of the conractor. In this connection special attention will be paid to the extent to which the Government has been called upon to arrange for furnishing "know-how" to the contractor.

I. The contribution that the contractor has made to the technical improvement and development of war matériel and production methods.

J. Special consideration will be given those contractors who have assisted other producers in performing a better job.

6. In cases where performance has been substantially or wholly completed, consideration will be given to the extent to which the contractor has met or anticipated delivery schedules.

7. The Board shall not be limited to the foregoing factors but may give consideration to any other factors which in its judgment are reasonably applicable. [190]

Method of Operation.

Information as to concerns making unreasonable profits or those paying excessive salaries or bonuses, or setting up excessive reserves, etc., will be obtained by the Board from the services, Division of Budget & Financial Administration, Contract Clearance Branch of the War Production Board, or any other sources.

All costs analyses are to be prepared by the Division of Budget and Financial Administration.

When the contractor is working for the Navy or the Maritime Commission as well as the Army, that department which has been assigned to the contractor will take charge of the case.

The Price Adjustment Board function will be completed when an agreement is arrived at with the contractor setting a limiting figure that shall be considered a reasonable profit before federal income and excess profit taxes. From this point forward, it is contemplated that the contractor will renegotiate contracts with the Service or Services involved so as to bring its total profit down to the agreed upon figure.

EXHIBIT F

Memorandum

Pursuant to Executive Order No. 9127, dated April 8, 1942, and for the purpose of controlling profits and costs under war contracts through adjustments with contractors, there have been established with the War Production Board, the War Department, the Navy Department and the Maritime Commission cost analysis sections. Further to implement control of costs and profits on war contracts, the following procedures will be established:

1. The War Department and the Navy Department and the Maritime Commission will each [191] create a board to be known as the Price Adjustment Board of the War Department, the Navy Department, or the Maritime Commission, as the case may be, to advise and assist the official in such Department or Commission in charge of purchasing, in securing adjustments or refunds in instances where

it is determined that costs or profits of contractors are, or may be, excessive for any reason. Each board shall exercise such other powers not inconsistent with this order as may be delegated to it by the Department or Commission which created it.

2. The Chairman of the War Production Board shall recommend a representative for appointment to each board. The Price Adjustment Boards may have one or more members in common.

3. The Cost Analysis Section of the War Production Board will conduct general surveys of the profits and costs of holders of war contracts and industry-wide studies of a like nature, either upon the request of one of the Price Adjustment Boards, or of the Cost Analysis Section of any Department, or upon its own initiative.

4. The Cost Analysis Sections of the War Department, Navy Department and the Maritime Commission will act as fact finding agencies for the Price Adjustment Boards and will upon the request of any Price Adjustment Board conduct investigations into the cost and profits of any contracts in which Departments or the Commission are interested. Any such investigation made upon the request of a Price Adjustment Board will be in such form and in such detail and will include such subject matter as such Price Adjustment Board may require. The Departments and the Commission will cooperate with each other in [192] order to avoid duplicating investigations of common contractors.

5. All cost analysis reports and all information obtained from contractors or otherwise by the various Cost Analysis Sections including that of the War Production Board and all information and records of the various Price Adjustment Boards will be available at all times to each of the Price Adjustment Boards and to each of the Cost Analysis Sections.

6. The Cost Analysis Sections of the War Production Board and of the Departments and the Commission are authorized to make use of the facilities of the Treasury Department, Securities and Exchange Commission, Federal Trade Commission and other proper departments or agencies of the Government in securing and assembling information.

7. Each Price Adjustment Board may establish such policies and procedures for the administration of its proceedings as it may deem proper. Every effort shall be made to keep the procedure of each board simple and flexible. Each board shall keep a written record of each action taken by it. Each board may delegate to any one or more of its members the power to initiate investigations, request information and assistance on behalf of the board and to represent the board in negotiations with contractors.

8. Where contractors have contracts with both Departments or with one or both of the Departments and the Commission, the Price Adjustment Boards of the Department or Commission involved shall agree as to how and by whom the negotiations shall be conducted. [193]

9. No audit shall be made by any Department or the Commission pursuant to Executive Order No. 9127 without first advising the Cost Analysis Section of the War Production Board.

(Signed) ROBERT P. PATTERSON,
Under Secretary of War.

(Signed) FORRESTAL,
Under Secretary of Navy.

(Signed) E. S. LAND,
Chairman, Maritime Commission.

Approved:

(Signed) D. M. NELSON,
Chairman, War Production Board.

EXHIBIT G

WAR DEPARTMENT
Washington

April 25, 1942.

Memorandum for Directors of all Staff Divisions, Services of Supply.
Chiefs of All Supply Services.
Chief of Each Administrative Service.
Commanding Generals of All Corps Areas.

Subject: Price Adjustment Board, Services of Supply.

1. There is created within the Services of Supply a Price Adjustment Board.

2. The mission of the Price Adjustment Board shall be to advise and assist the Chief of the Purchase Branch,

Procurement and Distribution Division, in securing adjustments and refunds in cases where it is thought that costs or profits of War Department con- [194] tractors are or may be excessive by reason of the payment of excessive salaries or bonuses or for any reason.

3. The members of the Board will be selected by the Commanding General, Services of Supply, with the approval of the Under Secretary of War. One member will be selected with the approval of the Chairman of War Production Board, as his representative.

4. The Board is instructed wherever appropriate to function jointly with representatives or agencies of the Navy Department, Maritime Commission, and other Departments or agencies of the Government.

5. The Board will receive from the Cost Analysis Section of the War Production Board, the Cost Analysis Section of the Fiscal Division of the Services of Supply, the Supply Services, the Army Air Force, and from any other source, information with respect to contractors who are thought to have excessive costs, to be making excessive profits, or to be paying excessive salaries or bonuses.

6. (a) The Cost Analysis Section of the Fiscal Division of the Services of Supply shall upon request of the Board make such audits and analyses as may be designated by the Board and shall secure for the Board from the Treasury Department, the Securities and Exchange Commission, the Federal Trade Commission, and from any other Department or agency of the Government, or from

the contractor involved, such additional information as the Board may request in order to expedite and assist it in the performance of its functions.

(b) All Divisions and personnel of the Services of Supply and the Army Air Force shall furnish such information and assistance to the Board as it may request or as may appear desirable to aid it in the performance of its functions. [195]

(c) To effect full coordination between the Services of Supply, the Army Air Force, and other Departments and to insure a uniform policy, price reductions which are offered to or contemplated by, the Services of Supply and the Army Air Force will be referred to the Chief of the Purchases Branch.

7. The Board is authorized to delegate to any one or more of its members the power to initiate investigations and request information and assistance on behalf of the Board and to represent the Board in negotiations with contractors. The Board shall develop such other policies and procedures as it may deem advisable in performing its functions and accomplishing its purposes.

8. The Board shall report to the Chief of the Purchases Branch, Procurement and Distribution Division, Services of Supply, its recommendations for adjustments with contractors. These recommendations, if approved by the Chief of the Purchases Branch and the Director or Deputy Director of the Procurement and Distribution Division, Services of Supply, shall be transmitted to the

Services concerned for the purpose of effecting any renegotiation or revision of contracts required in order to carry out such recommendations.

(Sgd.) BREHON SOMERVELL,
Brehon Somervell,
Lieutenant General,
Commanding.

Approved: April 25, 1942.

(Sgd.) ROBERT P. PATTERSON,
Robert P. Patterson,
Under Secretary of War. [196]

EXHIBIT H

WAR DEPARTMENT
HEADQUARTERS, SERVICES OF SUPPLY
Washington

March 13, 1942.

SP-PB-ppp 300.4.

P. B. General Directive No. 31.

To: The Chief, Chemical Warfare Service.
Chief of Engineers.
Chief of Ordnance.
The Quartermaster General.
Chief Signal Officer.
The Surgeon General.
Commanding General, Transportation Division.
Commanding Generals, all Corps Areas.
Commanding Officers, General Depots.

Subject: Use of Price Renegotiation Clause in Fixed Price Contracts.

1. It is essential to eliminate all delays in the production of items immediately required which result from the time required for the negotiation of fixed price contracts. In any case where in the opinion of the Contracting Officer it is desirable that the Contractor immediately commence production or preparation therefor, the Letter Purchase Order prescribed by P. & C. General Directive No. 5, dated January 13, 1942, may be issued pending such negotiation. Where actual production and delivery may occur prior to the execution of the contract, the words "partial payments and" or words of substantially similar import may be inserted in paragraph 4 of such Letter Purchase Order before the words "advance payments." [197]

2. Where a Letter Purchase Order is employed in accordance with paragraph 1 hereof, the contract should be negotiated at the earliest possible date even though final determination of price is impracticable at that time, and provision should be made in the contract for redetermination or renegotiation of the price, as authorized herein.

3. The Contracting Officer, in order to facilitate the execution of the contract and the commencement of work thereunder, may, pursuant to the authority of the First War Powers Act, 1941 (Public 354, 77th Cong.) and Executive Order #9001, insert in the contract and apply either of the following articles: (a) Redetermination of Price (Attachment 1), or (b) Renegotiation (Attachment 2).

4. It will be observed that Attachment 2 imposes upon the Contractor no legal obligation beyond that of furnishing a statement of actual costs and to renegotiate in good

faith. Such statement will afford a basis for renegotiation of the contract price. On the other hand, Attachment 1 calls for the application of definite objective standards, thereby making the redetermination of price largely automatic rather than dependent upon renegotiation.

(Sgd.) BREHON SOMERVELL,
Lieutenant General,
Commanding.

2 Incls:
Attach. 1,
Attach. 2.
Approved by:

ROBERT P. PATTERSON,
Under Secretary of War.

Attachment No. 1.

Article ..... *Redetermination of Price.*

The parties hereto recognize that, because of circumstances beyond their control, accurate estimates [198] of the cost of performing this contract cannot be made within a reasonable time. Accordingly, they agree that the price stated in Article 1 shall be redetermined as provided below, upon the basis of the actual experience of the Contractor in performing part of his contract. Such redetermination of the price shall be made as follows:

(a) The estimated cost of performing this contract, upon which the price stated in Article 1 is based, is $....., itemized as follows:[1]

A. Factory Cost:

1. Direct materials
2. Direct productive labor

---

[1]This breakdown may be altered to suit particular circumstances.

3. Direct engineering labor
4. Miscellaneous direct factory charges
5. Indirect factory expenses[2]

(State basis of allocation)

Total Factory Cost

B. Other manufacturing cost

C. Miscellaneous direct expenses

D. Indirect engineering expenses

E. Expenses of distribution, servicing and administration

F. Guarantee expenses

(b) It is agreed that the cost of production of the first .....% of items called for hereunder, hereafter referred to as the "preliminary run" will not necessarily be typical for the remainder of the contract. The cost of production of the next .....%, [199] hereafter referred to as the "test run" shall be used as the general basis for redetermination. Within ..... days after the completion of the production of the "test run", the Contractor shall submit to the Contracting Officer separate statements of the actual cost of the production of the "preliminary run" and the "test run", itemized in the same way as the estimated cost stated above. Such statement shall be based upon the cost accounting system regularly utilized by the Contractor and certified as correct by an independent public accountant or by two officers of the Contractor. The Contractor shall submit his books and

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[2]State separately the estimated amount of each of the following items included:

(a) Normal depreciation.

(b) Special amortization.

accounts to such examination and audit as shall be requested by the Contracting Officer.

(c) If the actual cost of production of the preliminary run plus the cost of the production of the remainder of the items called for by the contract, as indicated by the actual cost of production of the "test run", is less than the total estimated cost stated in paragraph (a), the total price to be paid pursuant to Article I shall be reduced in the same ratio.

(d) Pending the redetermination of the price hereunder, all items delivered shall be paid for at the price set forth in Article 1. Upon the redetermination of such price hereunder, an amount equal to the difference between the price paid on all items theretofore delivered and such redetermined price for such items shall be applied by the Contractor as a credit against payment for subsequent deliveries, or shall be applied or returned to the Government as directed by the Contracting Officer.

(e) If this contract contains an escalator clause (Price Adjustment), notwithstanding any provisions of such escalator clause which may be inconsistent herewith, that clause shall be understood to relate only to that portion of the production under the con- [200] tract which is not covered by the statements of actual cost required by paragraph (b) of this article. The blanks in the escalator clause will be filled in at the time of redetermination hereunder, and the month in which the redetermination is made shall be taken as the base month for such escalator

clause and the estimated labor costs and the estimated material costs shall include only such costs as are not reflected in the actual cost statements. For this reason the blanks in the escalator clause were not filled in at the time of the execution of this contract.

Attachment No. 2:

Article ..... *Renegotiation.*

(a) The Contractor represents that the contract price provided in Article ..... is based upon a total estimated cost of $..... itemized as follows:[1]

A. Factory Cost:

1. Direct materials
2. Direct productive labor
3. Direct engineering labor
4. Miscellaneous direct factory charges
5. Indirect factory expenses.[2]

(State basis of allocation)

Total Factory Cost

B. Other manufacturing cost

C. Miscellaneous direct expenses

D. Indirect engineering expenses

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[1]This break-down may be altered to suit particular circumstances.

[2]State separately the estimated amount of each of the following items included:

(a) Normal depreciation.

(b) Special amortization.

E. Expenses of distribution, servicing and administration

F. Guarantee expenses [201]

(b) Within ..... days after the completion of the production of .....% of the items called for under this contract, the Contractor shall submit to the Contracting Officer a statement of the actual cost of the production of said percentage, itemized in the same way as the estimated cost stated above. Such statement shall be based upon the cost accounting system regularly utilized by the Contractor and certified as correct by an independent public accountant or by two officers of the Contractor. The Contractor shall submit his books and accounts to such examination and audit as shall be requested by the Contracting Officer.

(c) Upon the written request of either party, which request shall be made within ..... days after the filing of the statement required by paragraph (b) hereof, the Contracting Officer and the Contractor will enter into negotiations and will attempt to agree upon a modification of the contract.

(d) Pending the renegotiation of the price hereunder, all items delivered shall be paid for at the price set forth in Article 1. Upon the renegotiation of the price hereunder, an amount equal to the difference between the price paid on all items theretofore delivered and such renegotiated price for such items, if in the Government's

favor, shall be applied by the Contractor as a credit against payment for subsequent deliveries, or shall be applied or returned to the Government as directed by the Contracting Officer; if in the Contractor's favor, it shall be paid by the Government on a separate invoice or voucher.

(e) If this contract contains an escalator clause (Price Adjustment) the figures set forth therein and the terms thereof shall be controlling in the absence of a modification of the contract under this article. In the event of such a modification, the escalator clause shall be so modified as to relate only to that portion of [202] the production under the contract which is not covered by the statement of actual cost required by paragraph (b) of this article. In modifying the provisions of the escalator clause, the month in which the renegotiation occurs shall be taken as the base month, and the estimated labor costs and the estimated material costs shall include only such costs as are not reflected in the actual cost statement submitted under paragraph (b) hereof.

EXHIBIT I

JOINT RESOLUTION TO PROVIDE FOR THE RENEGOTIATION OF CONTRACTS FOR THE PRODUCTION OF WAR MATERIALS FOR THE PURPOSE OF LIMITING PROFITS THEREUNDER

Whereas it is imperative that effective measures be taken to limit the profits paid to contractors obtaining contracts for the production of war materials; therefore, be it

Resolved by the Senate and the House of Representatives of the United States, in Congress assembled, That—

1. The Secretary of War is directed to insert in any contract hereafter made by the War Department, which, in his judgment, may result in an excessive profit to the contractor, a provision for the renegotiation of the contract price at a period when the profits can be determined with reasonable certainty.

2. The Secretary of War is directed, whenever in his opinion excessive profits have been realized, or are likely to be realized, from any contract with the War Department, to require such contractor to renegotiate the contract price. This provision shall be applicable to all contracts hereafter made and to all contracts heretofore made, whether or not such contracts contain a renegotiation clause, provided that final pay- [203] ment has not already been made pursuant to such contract.

3. In renegotiating a contract price the Secretary of War shall not make allowance for any salaries, bonuses, or other compensation paid by the contractor to its officers or employees, in excess of a reasonable amount, nor shall

he make allowance for any excessive reserves set up by the contractor, and the Secretary of War shall freely use the powers of audit conferred upon him by existing law for the purpose of ascertaining whether such unreasonable compensation has been or is being paid, or whether such excessive reserves have been set up.

4. In addition to the powers conferred by existing law, the Secretary of War shall have the right to demand of any contractor who holds uncompleted contracts with the United States for the production of war materials in the aggregate amount of $500,000 or more statements of actual costs of production and such other financial statements, at such times and in such form and detail as the Secretary of War may require.

5. The authority and discretion herein conferred upon the Secretary of War may be by him delegated to such individuals or agencies in the War Department as he may designate and he may authorize such individuals to make further delegations of such authority and discretion.

6. The foregoing provisions shall be applicable to the Secretary of the Navy in the case of contracts with the Navy Department, and to the Chairman of the Maritime Commission in case of contracts with that Commission. The powers conferred by paragraph 4 above shall be exercised by the War Department, the Navy Department, or the Maritime Commission, whichever holds the largest aggregate amount of uncompleted contracts for the production of war materials.

[Endorsed]: Filed Jan. 28, 1946. [204]

[Title of District Court and Cause]

AFFIDAVIT

Walker W. Lowry, being first duly sworn, deposes and says.

1. I am an attorney employed by the Department of Justice, Washington, D. C.

2. Attached hereto is a full, true and correct copy of the amended petition for redetermination of excessive profits filed in the Tax Court by Magnesium Products, Inc., (Docket No. 61-R).

WALKER W. LOWRY
Attorney, Dept. of Justice

Subscribed and sworn to before me this 9th day of January, 1946.

GLADYS E. McGAFFEY
Notary Public

My commission expires 9/30/48. [205]

COPY

The Tax Court of the United States
Docket No. 61-R

Magnesium Products, Inc., a corporation, Petitioner, vs. Henry L. Stimson, as Secretary of War of the United States of America, and Robert P. Patterson, as Under Secretary of War of the United States of America, Respondents.

AMENDED PETITION FOR REDETERMINATION OF EXCESSIVE PROFITS UNDER RENEGOTIATION ACT

The petitioner above named hereby petitions for a redetermination of excessive profits under the Renegotiation Act as set forth in the Unilateral determination of the Under Secretary of War in his notice of "Determination of Excessive Profits" dated 6 June 1944, and as a basis for its petition alleges:

1. The petitioner is a corporation organized and existing under and by virtue of the laws of the State of California with its principal place of business located at 1119 Santa Fe Avenue, Los Angeles, California. [206]

2. That this proceeding is one seeking a redetermination of alleged excessive profits under Section 403 of Title IV of Sixth Supplemental National Defense Appropriation Act, 1942 (Public 528, 77th Congress, approved April 28, 1942), as amended by Section 801 of the Revenue Act of 1942 (Public 753, 77th Congress, approved October 21, 1942), by Section 1 of the Military Appropriations Act, 1944 (Public 108, 78th Congress, approved July 1, 1943), and by Public 149 (78th Congress, ap-

proved July 14, 1943), and as further amended by Section 701 (b) of the Revenue Act of 1943 (Public 235, 78th Congress, enacted February 25, 1944) to the extent that Section 701(d) of the Revenue Act of 1943 makes the amendments made by Section 701 (b) effective as if they had been a part of Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, on the date of its enactment, April 28, 1942, hereinafter referred to as Renegotiation Act.

3. That the "Unilateral Determination of Excessive Profits", (a copy of which is attached hereto as "Exhibit A" and is by this reference incorporated herein as though set forth in full at this portion of this petition) was mailed to petitioner on June 6, 1944.

4. That the alleged excessive profits are for the period beginning March 1, 1942 and ending on November 30, 1942 and that the amount thereof is $250,000.00. [207]

5. That petitioner is engaged in the business of operating a jobbing foundry wherein it fabricates and sells magnesium alloy and castings; that all of the business done by petitioner during the period under review ending November 30, 1942, was with private individuals, firms and corporations and not with the United States of America; that petitioner has no contracts, as such, with any person, firm or corporation or with the United States of America; that all of its said business is and was done upon purchase orders, forwarded to petitioner by its customers; that all of the magnesium alloy sand castings fabricated and sold by petitioner, during the period under review, were sold below the maximum price which had been established and was in effect under the Emer-

gency Price Control Act of 1942 as amended and were sold at a price below the January 1, 1941 selling price.

6. The determination of the assailed excessive profits contained in "Exhibit A" hereto is based upon the following errors:

(a) The Under Secretary erred in refusing to take into consideration the corresponding profits made by petitioner in pre-war years;

(b) The Under Secretary erred in disregarding the contingent liability which exists for rejected castings; [208]

(c) The Under Secretary erred in disregarding the pricing policy followed by petitioner and the voluntary price reductions made by it since 1941;

(d) The Under Secretary erred in disregarding the comparative prices for the same product in the industry;

(e) The Under Secretary erred in disregarding the voluntary price reduction made by petitioner in July of 1943 whereby a saving of approximately $70,000.00 to the airframe companies was effected;

(f) The Under Secretary erred in disregarding the fact of petitioner's low cost of production, low overhead and administrative costs;

(g) The Under Secretary erred in disregarding the fact that petitioner is entirely financed by its stockholders and that it has never borrowed from or been financially assisted by the government;

(h) The Under Secretary erred in refusing to give consideration to petitioner's contribution to the war effort in the development of the use of magnesium, or to the

furnishing of technical assistance, supplies and equipment to others engaged in fabricating magnesium castings in the war effort;

(i) The Under Secretary erred in eliminating from consideration an adequate reserve, as determined by good [209] accounting practices, against contingent liabilities and the cost of reconversion to peace time business.

7. The facts upon which the petitioner relies are as follows:

(a) An analysis of the earnings of petitioner corporation, during the period under review, is as follows:

Net Sales	$1,326,940.37
Cost of Sales	784,743.29
Gross Profit on Sales	542,197.08
Commissions Earned	3,368.10
Discounts Earned	1,104.29
Net Profit on Sales	$ 546,669.47
Federal Income Taxes	381,592.38
Earnings for Year of 1942	$ 165,077.09
Percent of Sales	12.5%

(b) The petitioner corporation has not earned an excessive profit during the period under review when consideration is given to the corresponding profits in prewar years. Petitioner earned 27.3% in the year 1940 and 20.6% in the year 1941. The fact that the petitioner is entitled to as great a margin of profit as that obtained under competitive conditions in normal times has been completely ignored.

(c) Petitioner is subject to a contingent liability [210] for rejected castings. Approximately six months production of petitioner's castings are now in storage, x-ray laboratories and in the process of machining. As the demand slackens or a design change takes place, the airframe companies will reject these obsoleted castings. This contingent liability is real and could very well exceed twice the amount of the sum proposed to be left to petitioner after renegotiation. This liability cannot be determined within the period of one year and no provision has been made under the proposed renegotiation for the protection of petitioner's stockholders in the event loss occurs.

(d) Petitioner has supplied castings in an open competitive market and has, since October 1941, consistently sold at a price below the O.P.A. ceiling as set by Maximum Price Regulation No. 125. In 1940 petitioner voluntarily established a blanket price for all magnesium castings of $2.35 per pound; this price was made without regard to the difficulty of castings or intricacy of design; in 1941 petitioner voluntarily reduced the blanket price to $2.30 per pound; in January of 1942 petitioner voluntarily reduced its price to $2.25 per pound; in February of 1943 petitioner complied with the O.P.A. request for reduction of 3¢ per pound based upon its computation of saving due to the roll back in the ingot [211] price of magnesium of 2¢ per pound. This price of $2.22 per pound was well below the ceiling price and far below the price charged by petitioner's competitors in this or any other market area.

(e) The petitioner, in July of 1943, voluntarily reduced the price of all castings to $2.00 per pound thereby effecting a saving to its customers, for the balance of the

fiscal year, of approximately $70,000.00. This saving more than offsets the amount of recovery sought by renegotiation and was made by petitioner as a means of settling this controversy.

(f) The petitioner corporation has been entirely financed by its stockholders who have assumed all of the risks; petitioner has never borrowed from nor been financially assisted by the government or any agency thereof.

(g) Petitioner has, during its entire history, cooperated with its competitors in furthering the war effort in the development of the use of magnesium and in the furnishing of technical assistance, supplies and equipment to other competing firms engaged in fabricating magnesium castings in the war effort.

8. That the petitioner herein has never signed, [212] agreed, subscribed or assented to said renegotiation or the determination of alleged excessive profits by the respondents or the amount thereof but on the contrary has expressly refused to agree thereto.

9. That petitioner is advised and alleges that, as and if applied to the petitioner or to the business of the petitioner, said Renegotiation Act and each and every section and subdivision thereof under which said Unilateral Determination was made are, and each of them is, void and unconstitutional as being violative of the Constitution of the United States and that neither of the respondents herein had the power or authority to make said Unilateral Determination of June 6, 1944 and that neither of the respondents have the power or authority to enforce said Unilateral Determination according to its terms or otherwise for the reason that said Renegotiation Act is un-

constitutional and void, without lawful effect and repugnant to the Constitution of the United States, in the following among other particulars, to-wit:

(a) As and if applied to the petitioner said Renegotiation Act is an unauthorized attempt to delegate legislative authority to the respondents and to the Secretaries of the various departments as set forth in said act, contrary and repugnant to Article I, Section 1 and Article II, Section 8, [213] Paragraph 18 of the Constitution of the United States of America and to Articles V, IX and X of the Amendments thereto;

(b) As and if applied to petitioner, said Renegotiation Act and its enforcement would deprive petitioner of its property without due process of law, in violation of the Fifth Amendment to the Constitution of the United States of America;

(c) As and if applied to petitioner, said Renegotiation Act and its enforcement would take petitioner's property for public use without just or any compensation, in violation of the Fifth Amendment to the Constitution of the United States of America;

(d) As and if applied to petitioner, said Renegotiation Act and its enforcement is repugnant to the Tenth Amendment to the Constitution of the United States of America in that it attempts to exercise a power not delegated to the United States.

(e) As and if applied to the Petitioner, said Renegotiation Act and its enforcement is in violation of Article I, Section 1 and Article II, Section 8, Paragraph 18 of the Constitution of the United States of America and of the Fifth and Tenth Amendments thereto, in that by said

Renegotiation Act it is provided that "Whenever, in the opinion of the [214] Secretary of a department (including the Secretary of War) the profits realized or likely to be realized from any contract with said department or from any subcontract thereunder, whether or not made by the contractor, may be excessive, the Secretary is authorized and directed to require the contractor or subcontractor to renegotiate the contract price", and that upon said renegotiation "the Secretary is authorized and directed to eliminate any excessive profits under such contract or subcontract"; that neither said Renegotiation Act nor any other provision of law sets forth or declares any rules, standard guide or policy by which said Secretary is to be guided in the administration of said Act or in the determination of what are or are not excessive profits other than the arbitrary order, whim or caprice of said secretary; that by said Act Congress has attempted to delegate to the secretary the power to refix contract prices and has directed, authorized and empowered him, by unguided opinion and without setting forth any standard guage or rule, to determine what profits are excessive;

(f) As and if applied to the petitioner, said Renegotiation Act and its enforcement further violates said foregoing provisions of the Constitution and the Fifth and Tenth Amendments thereto in that it purports to vest in the secretary [215] the power to renegotiate contracts made and entered into between private persons, firms and corporations and to which contracts the government of the United States is not a party, and in instances where no privity of contract exists between the contractor or subcontractor and the United States;

(g) As and if applied to the petitioner, said Renegotiation Act is further repugnant to said Articles of the Constitution of the United States and of said Fifth and Tenth Amendments thereto, in that it provides that upon any renegotiation conducted and made and upon any order entered pursuant thereto by the secretary, said secretary may make a revision of said contracts renegotiated by reducing the contract price of said contract, but said Renegotiation Act contains no provision whereby the contractor can have his contract price raised in the event that such contract price did not produce a fair profit on the business done under said contract or any profit at all;

(h) As and if applied to the petitioner, said Renegotiation Act is further repugnant to said Articles of the Constitution and to said Fifth and Tenth Amendments thereto in that it does not provide for any equality of treatment as to all persons, firms or corporations whose contracts are made subject to the provisions of said Act, in the following [216] particulars, to-wit:

(1) That by the provisions of said Act the secretary is authorized, in his discretion, to exempt from some or all of the provisions of said Act "any contracts or subcontracts under which, in the opinion of the secretary, the profits can be determined with reasonable certainty when the contract price is established – – – when the period of performance under said contract or subcontract will not be in excess of thirty days;

(2) That by the provisions of said Act the secretary may exempt from the provisions of said Act a portion of any contract or subcontract during a specified period or periods if in the opinion of the secretary the provi-

sions of the contract are otherwise adequate to prevent excessive profits;

(3) That by the provisions of said Act the secretary is authorized to exempt contracts and subcontracts, both individually and by general classes and types;

(4) That said Renegotiation Act is made to apply only to contracts involving amounts in excess of $100,000.00 and does not apply to contracts involving amounts less than $100,000.00;

(i) As and if applied to the petitioner, said Renegotiation Act is further violative of said articles of the Constitution and Amendments in that it directs the secretary [217] in determining excess profits under any contract not to make any allowances for any salaries, bonuses or other compensation paid by a contractor to its officers or employees in excess of a reasonable amount and not to make allowance for any excess reserves set up by the contractor or for any costs incurred by the contractor which are excessive and unreasonable; that said Act does not contain any standard, guide or rule for the determination of what are reasonable salaries, bonuses or compensation or for the determination of what are or are not excessive or unreasonable reserves;

(j) As and if applied to the petitioner, said Renegotiation Act further violates said Articles of the Constitution and Amendments thereto in that it authorizes the secretary, without any rule or standard to guide his discretion to exempt from renegotiation contracts or portions of contracts made or to be performed during a specified period or periods of time, said period or periods of time to be fixed by the arbitrary action of the secretary;

(k) That in exercising the purported power to determine excess profits the Renegotiation Act does not contain any limitation upon or description of the character of the material or data which the secretary may consider;

(l) That said Renegotiation Act further violates [218] said foregoing provisions of the Constitution of the United States of America and Amendments thereto in that the Congress of the United States has provided other statutory enactments applicable to corporations which provide a uniform method to exact taxes at high rates upon corporate earnings which, because of the war, are beyond normal which statutory enactment is commonly known as the Corporation Income and Excess Profit Tax and that the Renegotiation Act is as and if applied to petitioner and its business a taxing measure and its enforcement will further tax petitioner's excess profits without any uniform standard or guide for the determination of such income as represents excess profits.

10. The foregoing specifications of errors are based upon information and belief of petitioner; in this regard petitioner alleges that it has never been given a statement of the findings of fact or reasons upon which said Unilateral Determination was made; in the event petitioner is furnished with a statement of the reasons and basis for said Unilateral Determination petitioner will ask leave of Court to amend this petition to set forth any additional specifications of error which might be revealed by any subsequent statement or finding by the Secretary.

Wherefore petitioner prays that this Honorable Court [219] may hear the proceeding and determine that petitioner has in fact earned no excessive profits during the period under review; that the Court order, adjudge and

decree that the Renegotiation Act as applied to petitioner is unconstitutional, null and void, and unenforceable and that petitioner have such other and further relief as may be just and proper.

RUFUS BAILEY
ROBERT M. L. BAKER
639 South Spring Street
Los Angeles 14, California [220]

[Verified.] [221]

[EXHIBIT A]

WAR DEPARTMENT
OFFICE OF THE UNDER SECRETARY
Washington

DETERMINATION OF EXCESSIVE PROFITS

Pursuant to Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, which term refers to said Act as last amended 14 July 1943 and as affected by Title VII of the Revenue Act of 1943 so far as applicable.

Whereas, Magnesium Products, Inc. (hereinafter referred to as the Contractor), holds contracts and subcontracts subject to renegotiation pursuant to the provisions of Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended (hereinafter referred to as the Act); and

Whereas, renegotiation has taken place between the Under Secretary of War and the Contractor, pursuant to the provisions of the Act, for the purpose of eliminating excessive profits realized by the Contractor during its

fiscal year ended 30 November 1942, under said contracts and subcontracts; and

Whereas, as a basis for said renegotiation the Under Secretary of War considered certain financial, operating and other data, submitted by the Contractor or obtained by the Under Secretary of War from governmental or other reliable sources, relating to the profits realized by the Contractor during said fiscal year under said contracts and subcontracts; and

Whereas, the Contractor has been granted full opportunity to submit such additional information and to present such contentions as the Contractor deemed material in determining the excessiveness of said profits and the renegotiability of such contracts and subcontracts, at hearings of which due notice was given, and due consideration has been given to the financial, operating and other data and information so furnished or obtained and each of the contentions so presented;

Now, Therefore, pursuant to the authority and discretion vested in the Secretary of War, the Secretary of the Navy, the Secretary of the Treasury, the Chairman of the Maritime Commission, the Administrator of the War Shipping Administration, and the respective Boards of Directors of the Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation and Rubber Reserve Company under the provisions of the Act, and duly delegated to the Under Secretary of War under subsection (f) thereof, it is hereby found and determined:

That $250,000 of the profits realized by the Contractor during its fiscal year ended 30 November 1942, under its contracts and subcontracts subject to renegotiation pursuant to the provisions of the Act, are excessive.

That in connection with the payment or discharge by any means of the amount of excessive profits determined hereby to have been realized by the Contractor, the Contractor shall be credited with any amount to which it may be entitled under Section 3806 of the Internal Revenue Code as computed by the Commissioner of Internal Revenue. [222]

That the Contractor is directed to repay such excessive profits less such tax credit, if any, to the Treasurer of the United States.

That the excessive profits so found and determined shall be eliminated by any of the methods provided in the Act or any combination thereof; and the Commanding General, Army Service Forces, and the Commanding General, Army Air Forces, are hereby authorized and directed to take any and all action which may be necessary or desirable to effect such elimination.

6 June 1944

Robert P. Patterson
ROBERT P. PATTERSON
Under Secretary of War

APRAR-8
5-17-44 24-55147ABC

[Endorsed]: Filed Jan. 28, 1946. [223]

[Title of District Court and Cause]

AFFIDAVIT

K. L. Brazier, being first duly sworn, deposes and says:

1. I am a Lieutenant Colonel in the Finance Department of the Army of the United States and I am the Assistant in charge of the Special Financial Services Division of the Office of the Fiscal Director.

2. Attached to this affidavit are full, true and correct copies of the following documents.

(a) The order and determination of Robert P. Patterson, Under Secretary of War, dated June 6, 1944, determining the amount of excessive profits realized by Magnesium Products, Inc., during its fiscal year ended November 30, 1942.

(b) A withholding order dated September 6, 1944, from Robert P. Patterson, Under Secretary of War, to North American Aviation, Inc.

(c) A telegram dated October 14, 1944, from Robert P. Patterson to North American Aviation, Inc., amending the withholding order of September 6, 1944. [224]

(d) A telegram dated October 19, 1944, from Robert P. Patterson to North American Aviation, Inc., further amending the withholding order of September 6, 1944.

(e) A letter dated July 21, 1945, from R. P. Hueper, Acting Fiscal Director to North American Aviation, Inc., further amending the withholding order of September 6, 1944.

K. L. BRAZIER
Lt. Colonel, F. D.

Sworn to and subscribed before me this 8 day of January, 1946.

JOHN A. SULLIVAN
~~Notary~~ ~~Public~~
Major, (AG)

~~My~~ ~~commission~~ ~~expires~~ [225]

COPY

WAR DEPARTMENT
OFFICE OF THE UNDER SECRETARY
Washington

DETERMINATION OF EXCESSIVE PROFITS

Pursuant to Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, which term refers to said Act as last amended 14 July 1943 and as affected by Title VII of the Revenue Act of 1943 so far as applicable.

Whereas, Magnesium Products, Inc. (hereinafter referred to as the Contractor) holds contracts and subcontracts subject to renegotiation pursuant to the provisions of Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended (hereinafter referred to as the Act); and

Whereas, renegotiation has taken place between the Under Secretary of War and the Contractor, pursuant to the provisions of the Act, for the purpose of eliminating excessive profits realized by the Contractor during its fiscal year ended 30 November 1942, under said contracts and subcontracts; and

Whereas, as a basis for said renegotiation the Under Secretary of War considered certain financial, operating and other data, submitted by the Contractor or obtained by the Under Secretary of War from governmental or other reliable sources, relating to the profits realized by the Contractor during said fiscal year under said contracts and subcontracts; and

Whereas, the Contractor has been granted full opportunity to submit such additional information and to present such contentions as the Contractor deemed material in determining the excessiveness of said profits and the renegotiability of such contracts and subcontracts, at hearings of which due notice was given, and due consideration has been given to the financial, operating and other data and information so furnished or obtained and each of the contentions so presented;

Now, Therefore, pursuant to the authority and discretion vested in the Secretary of War, the Secretary of the Navy, the Secretary of the Treasury, the Chairman of the Maritime Commission, the Administrator of the War Shipping Administration, and the respective Boards of Directors of the Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation and Rubber Reserve Company under the provisions of the Act, and duly delegated to the Under Secretary of War under subsection (f) thereof, it is hereby found and determined:

That $250,000 of the profits realized by the Contractor during its fiscal year ended 30 November 1942, under its

contracts and subcontracts subject to renegotiation pursuant to the provisions of the Act, are excessive.

That in connection with the payment or discharge by any means of the amount of excessive profits determined hereby to have been realized by the Contractor, the Contractor shall be credited with any amount to which it may be entitled under Section 3806 of the Internal Revenue Code as computed by the Commissioner of Internal Revenue.

That the Contractor is directed to repay such excessive profits less such tax credit, if any, to the Treasurer of the United States.

That the excessive profits so found and determined shall be eliminated by any of the methods provided in the Act or any combination thereof; and the Commanding General, Army Service Forces, and the Commanding General, Army Air Forces, are hereby authorized and directed to take any and all action which may be necessary or desirable to effect such elimination

6 June 1944

(S) ROBERT P. PATTERSON
Robert P. Patterson
Under Secretary of War

SPRAR-8
5-17-44

24-55147 [226]

SPRAR 6 September 1944.

North American Aviation, Inc.,
Inglewood, California

Subject: Direction to Withhold from Magnesium Products, Inc., of Los Angeles, California, pursuant to the Renegotiation Act.

Gentlemen:

Pursuant to the authority vested in the Secretary of War under Section 403 of the Sixth Supplemental National Defense Appropriation Act, 1942, as amended, and duly delegated to me, I found and determined on 6 June 1944 that certain of the prices and profits realized by Magnesium Products, Inc., during its fiscal year ended 30 November 1942 under contracts and subcontracts subject to renegotiation were excessive.

In accordance with the authority and duty to eliminate said excessive profits (after allowing to said Magnesium Products, Inc. credit for Federal taxes and provided in Section 3806 of the Internal Revenue Code) I hereby direct you to withhold for the account of the United States any and all amounts (not in excess of $40,000 in the aggregate (otherwise due or which shall become due from you to said Magnesium Products, Inc.

This direction shall be effective immediately and shall continue in effect until further notice from me.

You are also directed to report in writing to the Chairman of the War Department Price Adjustment Board,

Room 3D 573, The Pentagon, any amounts which you may from time to time withhold for the account of the United States pursuant hereto.

Very truly yours,

ROBERT P. PATTERSON
Under Secretary of War

FF:hhb COPY [227]

72867

ASF, PRICE ADJUSTMENT BOARD RENEGOTIATION DETERMINATION SPRAR ROOM 3D 573, THE PENTAGON, WASHINGTON 25, D. C.

NORTH AMERICAN AVIATION, INC.
INGLEWOOD
CALIFORNIA

14 OCTOBER 1944

MY LETTER 6 SEPTEMBER 1944 DIRECTING YOU TO WITHHOLD $40,000 FROM MAGNESIUM PRODUCTS, INC. FOR ACCOUNT THE UNITED STATES IS HEREBY AMENDED AS FOLLOWS:

YOU ARE TO CONTINUE TO WITHHOLD SUCH AMOUNTS AS WERE OTHERWISE DUE FROM YOU TO MAGNESIUM PRODUCTS, INC. AT THE CLOSE OF BUSINESS ON 14 OCTOBER 1944 WHICH AMOUNTS I UNDERSTAND TOTAL NOT LESS THAN $24,462.24.

YOU ARE TO WITHHOLD NO ADDITIONAL AMOUNTS UNTIL 30 OCTOBER 1944 ON WHICH DATE YOU ARE TO RESUME WITHHOLDING IN ACCORDANCE WITH MY LETTER OF 6 SEPTEMBER 1944 UNTIL THE TOTAL OF AMOUNTS WITHHELD THROUGH 14 OCTOBER 1944 AND AFTER 30 OCTOBER 1944 IS $33,500.

ROBERT P. PATTERSON
UNDER SECRETARY OF WAR

OFFICIAL
G. K. HEISS
COLONEL, ORDNANCE DEPARTMENT
EXECUTIVE ASSISTANT

DRStuart; fm COPY [228]

19 OCTOBER 1944
72868

ASF, PRICE ADJUSTMENT BOARD RENEGOTIATION DETERMINATION SPRAR ROOM 3D 573, THE PENTAGON, WASHINGTON 25, D. C.

NORTH AMERICAN AVIATION, INC.
INGLEWOOD
CALIFORNIA

REFERENCE YOUR TELEGRAM 17 OCTOBER FROM JOHNSON STOP MY TELEGRAM 14 OCTOBER RESPECT TO MAGNESIUM PRODUCTS, INC. WITHHOLDING IS HEREBY AMENDED TO

REFER TO TOTAL OF NOT LESS THAN $16,866.43 IN LIEU OF $24,462.24 STOP RESPECT COD DELIVERY REFERENCE IS MADE TO LETTER DATED 13 OCTOBER FROM MAGNESIUM PRODUCTS, INC. RUFUS BAILEY, SECRETARY, TO DEPARTMENT OF JUSTICE WHICH AGREES THAT DURING PERIOD BETWEEN 13 OCTOBER AND 30 OCTOBER SALES TO YOU WILL BE ON QUOTE CUSTOMARY CREDIT TERMS UNQUOTE END

ROBERT P. PATTERSON
UNDER SECRETARY OF WAR

OFFICIAL:

G. K. HEISS
COLONEL, ORDNANCE DEPARTMENT
EXECUTIVE ASSISTANT

DRStuart; fm COPY [229]

SPFEU 167/490428 Magnesium Products Inc.

21 July 1945

North American Aviation, Inc.
Inglewood, California

Gentlemen:

Receipt is acknowledged of your letter dated 6 July 1945, in which you state that you have withheld from Magnesium Products Company, 1119 South Santa Fe

Avenue, Los Angeles 21, California, as of that date the sum of twenty thousand two hundred four dollars and three cents ($20,204.03), pursuant to the withholding directive of the Under Secretary of War.

Reference is made to withholding order dated 6 September 1944, whereby you were directed by the Under Secretary of War, to withhold monies otherwise due Magnesium Products Company in an amount not to exceed forty thousand dollars (40,000), as amended. Such withholding order is hereby further amended in that the maximum amount to be withheld from Magnesium Products Company is decreased from forty-thousand dollars (40,000) in the aggregate to twenty thousand two hundred four dollars and three cents (20,204.03) in the aggregate.

It is now requested that you continue withholding the twenty thousand two hundred four dollars and three cents (20,204.03), until further advice is received from this office as to disposition to be made of the amount withheld.

This office appreciates your cooperation in the matter.

Sincerely yours,

R. P. HUEPER
Brigadier General, USA
Acting, Fiscal Director

[Endorsed]: Filed Jan. 28, 1946. [230]

[Title of District Court and Cause]

SUPPLEMENTARY AFFIDAVIT OF E. R. CLAYTON IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT

State of California, County of Los Angeles—ss:

E. R. Clayton being first duly sworn deposes and says:

That he is now and continuously ever since the 6th day of December, 1938, has been the president of Magnesium Products, Inc., the plaintiff herein.

That all of the business done by plaintiff during the times herein mentioned, ending November 30, 1942, was with private individuals, firms and corporations and that all of its said business is and was done upon purchase orders, forwarded to plaintiff by its customers; that the plaintiff company had 447 contracts outstanding on November 30, 1942, and that the completed [231] work on these contracts as of that date amounted to $438,833.73; that the sales alleged to be subject to renegotiation as determined by the Price Adjustment Board is $966,352.11 which said figure represents the net sales from March 1, 1942 to November 30, 1942.

E. R. CLAYTON

Subscribed and sworn to before me this 21st day of September, 1946.

(Seal) RUFUS BAILEY

Notary Public in and for said County and State

[Endorsed]: Filed Oct. 8, 1946. [232]

[Title of District Court and Cause]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause came on for hearing before the Court without a jury on October 8, 1946, and the Court having denied the motion of plaintiff for summary judgment, and having denied the motion of intervenor, the United States of America, for summary judgment, and having considered the pleadings and the stipulations made and entered into in open court, and being now fully advised in the premises, now finds the facts and states the Court's conclusions of law as follows:

FINDINGS OF FACT

1. That at all times herein mentioned, plaintiff was and now is a corporation, organized and existing under and by virtue of the laws of the State of California, with its principal place of business located in the City of Los Angeles, California; that at all times herein mentioned, defendant was and now is a corporation, organized and existing under and by virtue of the laws of the State [233] of Delaware, and was and now is doing business within the State of California at Inglewood, Los Angeles County, California; and that the matter in controversy in this suit exceeds the sum or value of $3,000, exclusive of interest and costs.

2. During the year 1942, plaintiff was engaged in the manufacture of certain magnesium castings, all of which had a war end use. These magnesium castings were sold to defendant, North American and others, and as plaintiff well knew, they were used in the fabrication of aircraft and aircraft parts manufactured for and at the expense of the United States. After the enactment of the Renegotiation Act on April 28, 1942, plaintiff continued to enter into numerous purchase order contracts for the manufacture and sale of such castings and to make deliveries pursuant to those purchase orders.

3. After due notice to plaintiff, proceedings for the renegotiation of plaintiff's contracts and sub-contracts were had and conducted by representatives of the Secretary of War and thereafter, on the 6th day of June, 1944, the Under Secretary of War, acting under and by virtue of the Renegotiation Act and pursuant to authority delegated to him, duly determined in accordance with law, that of the profits realized by plaintiff during its fiscal year ended November 30, 1942, on its contracts and subcontracts subject to renegotiation, $250,000 thereof were excessive profits.

4. The tax credit to which plaintiff is entitled under Section 3806 of the Internal Revenue Code is in the amount of $184,376.63. This tax credit is computed upon the assumption that the profits determined to be excessive were returned as income by plaintiff for tax purposes, and that the appropriate taxes have been or will be paid on such profits.

5. That on or about September 6, 1944, the Under Secretary of War, acting pursuant to authority delegated to him under and by virtue of the Renegotiation Act, mailed to defendant an order directing the defendant to withhold for the account of the United States any and all amounts (not in excess of $40,000 in the aggregate) otherwise due or which should thereafter become due from defendant to plaintiff, which said withholding order was thereafter duly modified or amended by telegrams and a letter sent by various representatives of the Secretary of War acting under and by virtue of the Renegotiation Act, and *[234] pursuant to authority delegated to them respectively, whereby the amount which defendant was ultimately ordered to withhold from plaintiff was reduced to the amount of $20,204.03.

6. Pursuant to directions contained in the withholding order and amendments aforesaid, defendant, North American Aviation, Inc. has withheld for the account of the United States from amounts otherwise due plaintiff, the sum of $20,204.03.

7. The amount due the United States from plaintiff on account of plaintiff's renegotiation indebtedness to the United States for its fiscal year ended November 30, 1942 is equal to or greater than the said sum of $20,204.03 so withheld by defendant as aforesaid.

8. Defendant is not indebted to plaintiff on account of any of matters in issue in this case.

CONCLUSIONS OF LAW

1. That the Court has jurisdiction of the parties and of the subject matter of this action.

2. That the Renegotiation Act, as amended, is a valid exercise of the power of Congress and is in all respects constitutional.

3. That plaintiff is not entitled to recover in this action.

It Is Ordered that judgment shall be entered in conformity herewith.

Dated: October 16, 1946.

J. F. T. O'CONNOR
Judge, United States District Court

Approved as to Form:

RUFUS BAILEY
BAILEY & POE
Attorneys for Plaintiff

[Endorsed]: Filed Oct. 16, 1946. [235]

In the District Court of the United States in and for the Southern District of California
Central Division

No. 4390-O'C

MAGNESIUM PRODUCTS, INC., a corporation, 1119 Santa Fe Avenue, Los Angeles 21, California,
Plaintiff,

v.

NORTH AMERICAN AVIATION, INC., a corporation, Inglewood, California, Defendant.

JUDGMENT

This cause came on regularly for trial before the Court without a jury on October 8, 1946, and in conformity with the Court's Findings of Fact and Conclusions of Law, it is

Ordered and Adjudged that plaintiff take nothing by its suit and that defendant go hence without *day.*

Dated this 16th day of October, 1946.

J. F. T. O'CONNOR
Judge, United States District Court

Approved as to form
RUFUS BAILEY
BAILEY & POE
Attorneys for Plaintiff.

Judgment entered Oct. 16, 1946. Docketed Oct. 16, 1946. Book COB 40, page 246. Edmund L. Smith, Clerk; by Francis E. Cross, Deputy.

[Endorsed]: Filed Oct. 16, 1946. [236]

[Title of District Court and Cause]

NOTICE OF APPEAL

To the Circuit Court of Appeals:

Notice is hereby given that plaintiff, Magnesium Products, Inc., a corporation herein, does hereby appeal to the Circuit Court of Appeals for the Ninth Circuit from the order denying plaintiff's motion for a summary judgment and from the final judgment in favor of defendant that plaintiff take nothing herein which said order and judgment was entered in this action on the 16th day of October, 1946, in Civil Order Book 40, page 246.

Dated: December 11, 1946.

BAILEY & POE
By Rufus Bailey
By Arlo D. Poe

Attorneys for Plaintiff [237]

[Affidavit of Service by Mail.]

[Endorsed]: Filed; mld. copies to deft. counsel, Dec. 11, 1946. [238]

[Title of District Court and Cause]

CERTIFICATE OF CLERK

I, Edmund L. Smith, Clerk of the District Court of the United States for the Southern District of California, do hereby certify that the foregoing pages numbered from 1 to 243 inclusive contain full, true and correct copies of Complaint for Money; Answer; Motion for Summary Judgment; Notice of Motion for Summary Judgment; Affidavit of E. R. Clayton in Support of Motion for Summary Judgment; Response to Certification and Motion by United States to Intervene; Notice; Affidavit of Service; Order Allowing Intervention by United States; Answer of the United States; Affidavit of H. Struve Hensel; Affidavit of Robert P. Patterson; Affidavit of Walker W. Lowry; Affidavit of K. L. Brazier; Supplementary Affidavit of E. R. Clayton in Support of Motion for Summary Judgment; Findings of Fact and Conclusions of Law; Judgment; Notice of Appeal; Designation of Record on Appeal; Statement of Points on Appeal and Order Extending Time for Filing the Record and Docketing the Appeal which, together with copy of reporter's transcript of hearing on October 8, 1946, transmitted herewith, constitute the record on appeal to the United States Circuit Court of Appeals for the Ninth Circuit.

I further certify that my fees for preparing, comparing, correcting and certifying the foregoing record amount to $27.60 which sum has been paid to me by appellant.

Witness my hand and the seal of said District Court this 3rd day of March, A. D. 1947.

(Seal) EDMUND L. SMITH,
Clerk,
By Theodore Hocke,
Chief Deputy Clerk.

[Title of District Court and Cause]

Honorable J. F. T. O'Connor, Judge Presiding

REPORTER'S TRANSCRIPT OF PROCEEDINGS

Los Angeles, California
Tuesday, October 8, 1946

Appearances:

For the Plaintiff: Bailey & Poe, by Rufus Bailey, 639 S. Spring Street, Los Angeles 14, California.

For the Government: Robert E. Wright, Assistant United States Attorney.

Los Angeles, California, Tuesday, October 8, 1946, 2:00 P. M.

The Court: Mr. Cross, call the calendar.

The Clerk: Yes, your Honor. No. 4390 Civil, Magnesium Products, Inc., a corporation, versus North American Aviation, Inc., a corporation.

The Court: Are both sides ready?

Mr. Wright: Yes, your Honor.

Mr. Bailey: Yes, your Honor.

Mr. Wright: I am not sure, your Honor, as to whether the record is clear on the rulings yesterday as to the motion for summary judgment. Upon reference to my file here I find that the intervenor, the United States of America, moved for a summary judgment. The motion was filed January 28th, 1946.

The Court: In order to keep the record straight, that should be denied in view of our proceedings today. Let the record so show. Exception allowed the government.

Mr. Wright: Then there was a motion made by plaintiff, Magnesium Products Inc. for a summary judgment.

The Court: That motion will be denied and exception allowed the moving party.

Mr. Wright: Now I take it we are at trial on the merits of the case?

The Court: That is right. [2*]

Mr. Wright: Concerning the facts it is stipulated that during the year 1942 plaintiff was engaged in the manufacture of certain magnesium castings, all of which had a war end use. These magnesium castings were sold to the defendant North American Aviation and others and as plaintiff Magnesium Products Inc. well knew, they were used in the fabrication of aircraft and aircraft parts manufactured for and at the expense of the United States.

After the enactment of the Renegotiation Act on April 28, 1942, plaintiff continued to enter into numerous purchase order contracts for the manufacture and sale of such castings and to make deliveries pursuant to those purchase orders.

After due notice to the plaintiff, proceedings for the renegotiation of plaintiff's contracts and sub-contracts were had by representatives of the Secretary of War, and thereafter on the 6th day of June 1944 the Under Secretary of War, acting under and by virtue of the Renegotiation Act and pursuant to authority delegated to him, duly determined in accordance with law that profits realized by plaintiff during the fiscal year ending November 30, 1942 on those contracts and sub-contracts

*Page number appearing at top of page of original Reporter's Transcript.

subject to renegotiation, $250,000 thereof were excessive profits.

That the document annexed to the answer of Intervenor United States of America as Exhibit A is a carbon copy of the order of determination made and signed by the Under [3] Secretary of War on the 6th day of June, 1944.

That the tax credit to which plaintiff is entitled under Section 3806 of the Internal Revenue Code is $184,376.63. This tax credit is computed upon the assumption that the profits determined to be excessive were reported as income by plaintiff for tax purposes and that the appropriate taxes have been or will be paid on such profits.

On or about September 6, 1944 the Under Secretary of War mailed the defendant North American Aviation a directive to withhold from Magnesium Products Inc. of Los Angeles, California, pursuant to the Renegotiation Act. This withhold order was amended by telegram from the Under Secretary of War to the defendant North American Aviation dated October 14, 1944; by a further telegram dated October 19, 1944, and by a letter dated July 21, 1945.

That the documents annexed to the answer of the Intervenor the United States of America, marked Exhibits B, C, D and E are true copies of the withholding orders referred to.

That pursuant to these directives from the Under Secretary of War, defendant North American Aviation has withheld for the use and account of the United States from amounts otherwise due to plaintiff the sum of $20,204.03.

That plaintiff has filed a petition in the tax court of the United States asking for a redetermination of the amount if any of its excessive profits for its fiscal year ending [4] November 30, 1942. The tax court has not as yet heard plaintiff's case or rendered any decision thereon.

That the said amount of $20,204.03 now being withheld by defendant North American Aviation from plaintiff Magnesium Products pursuant to the withhold orders aforesaid represents amounts accrued to the credit of plaintiff as the result of its performance of the work provided for by the purchase orders aforesaid, all of which required the furnishing of materials and parts for the construction of airplanes for use by the United States in the promotion of the war effort.

Mr. Bailey: On that statement of facts, your Honor, we will so stipulate. Now, in addition to that there has been filed on the various motions for summary judgment an affidavit of E. R. Clayton on behalf of plaintiff, and there has been filed an affidavit of Robert P. Patterson and an affidavit of H. Struve Hensel on behalf of the United States.

We will stipulate that if these witnesses were called that they would testify substantially as they have in these affidavits.

Mr. Wright: And that is with the understanding. of course, that none of the facts set forth in any of the affidavits shall result in any way qualifying the stipulation as to the facts relating to the issues raised by the pleadings, which issues are now on trial. [5]

Mr. Bailey: Yes, it is so understood and stipulated.

Mr. Wright: Let it be further stipulated that the amount now due the United States on account of the

renegotiation indebtedness referred to in this stipulation is at least equal to or more than the amount of $20,204.03 now being withheld by defendant North American Aviation, Inc.

Mr. Bailey: It is so stipulated.

The Court: This action was filed in this court on April 19, 1945 and has been at issue for some time, and since the filing of the action the Circuit Court for the Ninth Circuit in Spaulding v. Douglas Aircraft Company, 154 Fed. 2nd at 419 disposed of the issues which were involved in the action now before the Court. A rehearing was denied in the Spaulding case on April 17, 1946. It was the opinion of the court that the opinion of the Circuit Court was controlling in the present case and for that reason the court requested counsel for the parties to appear in court and argue if there was any difference in the present issue and the decision rendered by our Circuit Court. The attorneys have appeared in court and have cooperated with the court in reaching a conclusion in this matter.

Our Circuit Court declared the Act constitutional and that is binding on this court. Judgment will be rendered accordingly. Findings of fact, conclusions of law and judgment will be prepared by the Intervenor, the United [6] States.

When can we have those, gentlemen?

Mr. Wright: I expect to dictate them this afternoon, your Honor. I haven't had a chance to this moment.

The Court: Mr. Bailey is going away, is he not?

Mr. Bailey: Not until the weekend, your Honor. I will be available the balance of this week except tomorrow morning.

Mr. Wright: We can get together tomorrow afternoon, your Honor.

The Court: I thought probably you could start now and get the matter disposed of.

Mr. Wright: Well, I will go down and dictate them. I think we have a perfect understanding.

The Court: Yes. I will agree, gentlemen. I think you have done a very fine job.

Mr. Bailey: Thank you very much, your Honor. I appreciate your courtesy.

[Endorsed]: Filed Feb. 24, 1947. [7]

[Endorsed]: No. 11556. United States Circuit Court of Appeals for the Ninth Circuit. Magnesium Products, Inc., a corporation, Appellant, vs. North American Aviation, Inc., a corporation, and United States of America, Appellees. Transcript of Record. Upon Appeal From the District Court of the United States for the Southern District of California, Central Division.

Filed March 4, 1947.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the Circuit Court of Appeals of the United States
Within and for the Ninth Circuit

No. 11556

MAGNESIUM PRODUCTS, INC., a corporation, 1119 Santa Fe Avenue, Los Angeles 21, California,
Plaintiff,

vs.

NORTH AMERICAN AVIATION, INC., a corporation, Inglewood, California, Defendant.

APPELLANT'S STATEMENT OF POINTS

Appellant and plaintiff Magnesium Products, Inc., a corporation, intends to rely on appeal on the following points:

1. That the 1942 Renegotiation Act (Section 403 of Title IV of the Sixth Supplemental National Defense Appropriation Act, 1942, ((Public 528, 77th Congress, approved April 28, 1942)) as amended by Section 801 of the Revenue Act of 1942), is unconstitutional and void as and if applied to plaintiff.

(a) The Act delegates legislative and judicial power to the Secretary, and authorizes him to take property from citizens of the United States as his "opinion" may dictate.

(b) The Act is vague and uncertain.

(c) The Act denies procedural due process.

(d) The Act operates retroactively and operates so as to destroy existing contractual rights.

2. That said 1942 Renegotiation Act has been unlawfully and unconstitutionally applied and administered against plaintiff so as to deprive plaintiff of its property without due process of law.

(a) The Act only authorizes bargaining by the Secretary, and not a unilateral determination.

(b) The Secretary has treated as renegotiable purchase orders which were not subcontracts.

(c) Defendant has treated contracts in sums less than One Hundred Thousand Dollars ($100,000) as subject to renegotiation.

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By Arlo D. Poe
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639 South Spring Street
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[Affidavit of Service by Mail.]

[Endorsed]: Filed Apr. 10, 1947. Paul P. O'Brien, Clerk.